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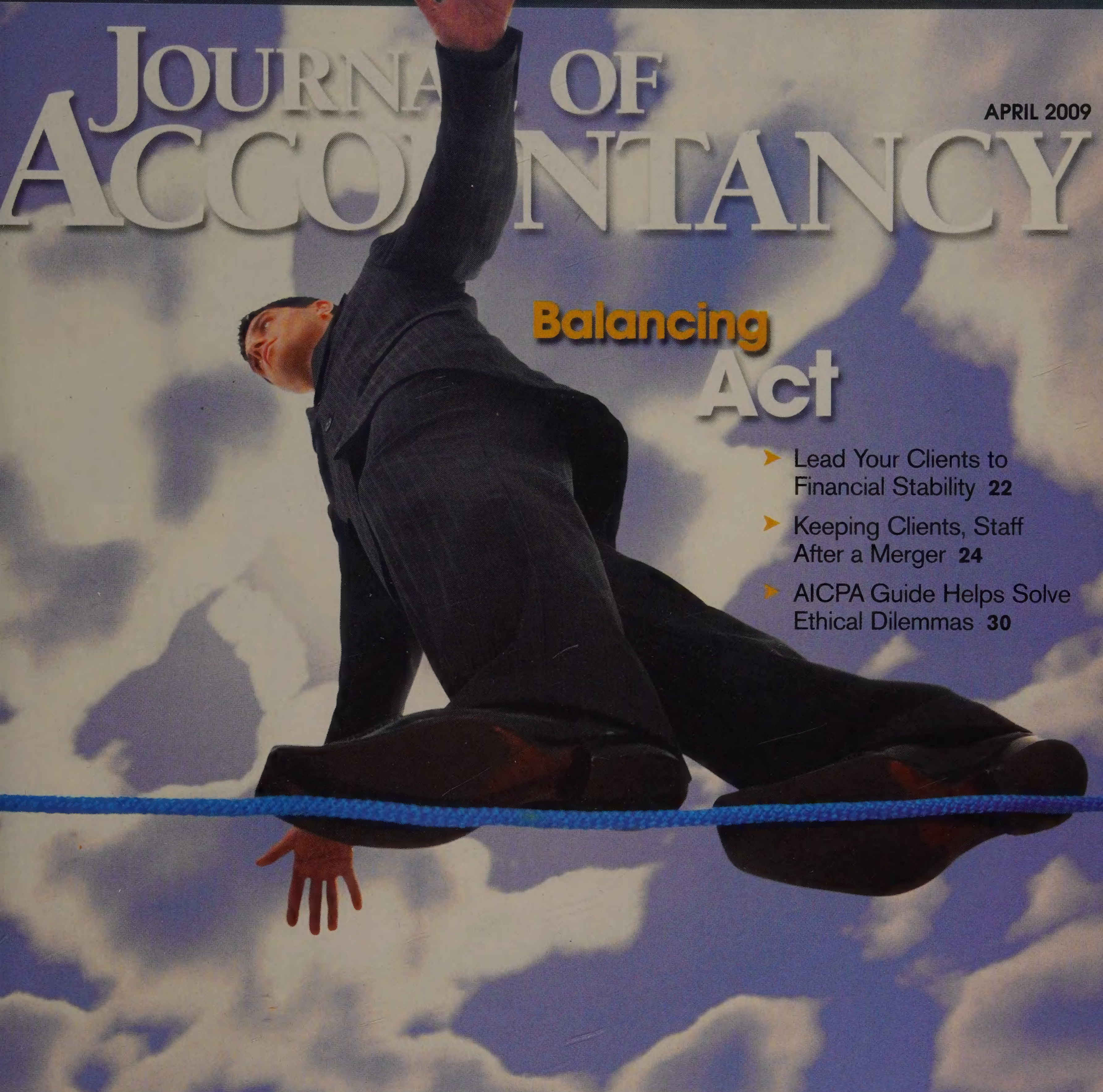

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▶ **For CPAs who prepare financial reports for public companies**

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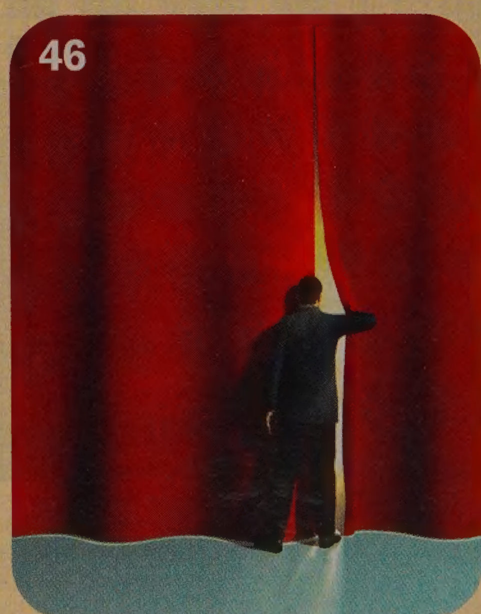

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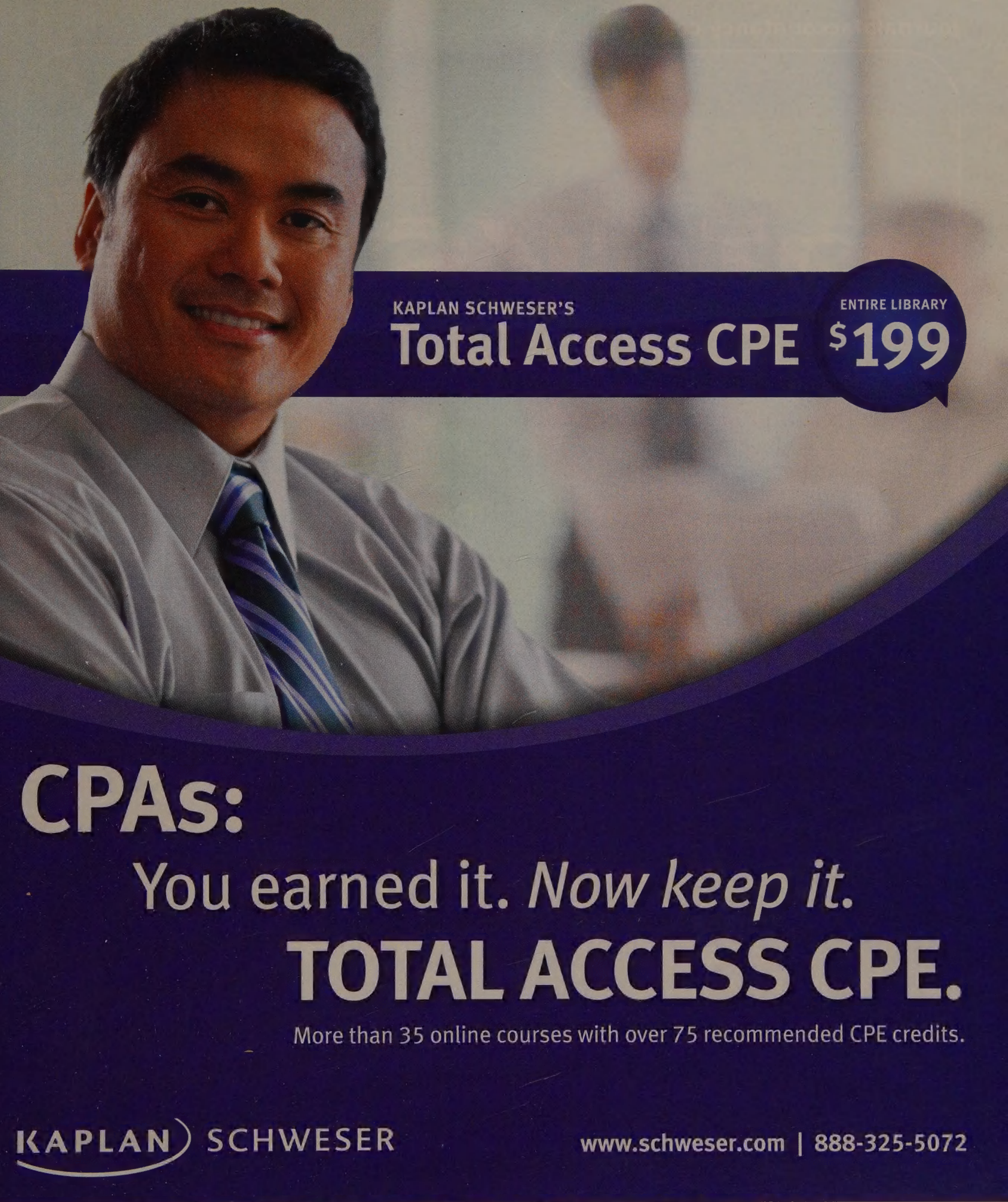

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Other-Than-Temporary Impairment

In the March 2009 issue, "Weathering the 'Other-Than-Temporary' Impairment Storm" (page 48) explained other-than-temporary impairment rules under U.S. GAAP. Now two Web-exclusive follow-up articles discuss impairment rules under IFRS and provide additional tips for determining whether the EITF 99-20 model applies to specific securities.

VIDEO

Business and Industry Economic Outlook

Accounting professor **Mark H. Lang** of the University of North Carolina's Kenan-Flagler Business School discusses the results of the first-quarter *AICPA/UNC Kenan-Flagler Economic Outlook Survey*, which drew responses from more than 1,100 CPA financial executives.

ARTICLE

Sample Letters for a Client Transition Plan

After a merger or acquisition, communication and consistent, positive messaging are essential for client retention. **Joel Sinkin** and **Terrence Putney**, CPA, offer sample client letters and messaging, focusing on benefits to the client, for use prior to the transition (also see "Keeping It Together," page 24).

VIDEO

Small Firm Survival Tips

Mark Koziel, CPA, senior technical manager for AICPA Specialized Communities Firm Practice Management/PCPS, discusses savvy practice management moves for a down economy, including ways to retain top talent when pay increases aren't an option.

The *new* journalofaccountancy.com: the best online resource for today's CPA

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Keeping It Together: Plan the Transition to Retain Staff and Clients page 24

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Help for Solving CPAs' Ethical Dilemmas page 30

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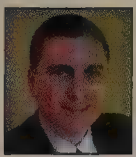
Stimulus Act Eases Taxes for Individuals, Small Businesses page 40



Alistair M. Nevius, J.D., is the editor-in-chief of *The Tax Adviser* and a contributing editor to the *Journal of Accountancy*. He is a graduate of the University of Chicago and Boston University School of Law and has spent 20 years in tax and legal publishing.

Paul Bonner is a senior editor of the *Journal of Accountancy* for taxation, personal finance and CPA education. He is also an adjunct instructor teaching news writing in the School of Journalism and Mass Communication at the University of North Carolina at Chapel Hill.

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Lewis Dulitz, CPA, is vice president of accounting policies and research for Covidien, a global health care company with revenues of nearly $10 billion and 41,000 employees in 59 countries. Previously, he worked on the IFRS transition team for Royal Ahold, a Netherlands-based company listed on stock exchanges in both the United States and Europe and prepared IFRS to U.S. GAAP reconciliations. He is a member of the Financial Accounting Standards Advisory Council and a frequent speaker on IFRS implementation.

IFRS Converges to U.S. GAAP on Segment Reporting page 50

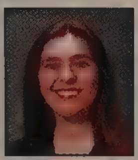
Barry Jay Epstein, CPA, Ph.D., is a partner in Russell Novak & Co. LLP in Chicago. His practice is concentrated on technical consultations on U.S. GAAP and IFRS, and as a consulting and testifying expert on civil and white collar criminal litigation matters. He is the co-author of *Wiley GAAP 09*, *Wiley IFRS 09*, *Wiley IFRS Policies and Procedures* and other books.

Eva K. Jermakowicz, CPA, Ph.D., has taught accounting for more than 25 years and has consulted international organizations and businesses. She is currently a professor of accounting and chair of the Accounting and Business Law Department at Tennessee State University. Her previous positions were at the University of Southern Indiana and at Warsaw Tech University in Poland. She was a Fulbright scholar in Brussels for the academic year 2003–2004, where her project was "Convergence of National Accounting Standards with International Financial Reporting Standards." She is the co-author of *Wiley IFRS 09: Interpretation and Application of International Financial Reporting Standards* and *Wiley IFRS Policies and Procedures*.

■ Tax Considerations for Buying and Selling Property With a Burdensome Lease page 51

Larry Maples, DBA, is a professor of accounting at Tennessee State University in Nashville, Tenn. He is the author of "Tax Accounting for Long-Term Contracts" in CCH's Federal Tax Service. He has published more than 90 articles in professional journals including the *Journal of Accountancy*, the *Journal of Taxation*, *The Tax Adviser* and others. He has received awards for teaching and research and in 2002 was named a Prolific Author of Accounting Literature in a study of the top 40 accounting-related journals.

Mark Turner, CPA, DBA, CMA, is an associate professor of accounting at the Cameron School of Business, University of St. Thomas, Houston. He has published articles in the *Journal of Accountancy* and other professional journals.



Beth Howard, Ph.D., is an assistant professor of accounting at Tennessee Tech University in Cookeville, Tenn. She has published articles in the *Journal of Accountancy* and *Municipal Finance Journal*.

■ Simplify and Improve Your Office System page 55

Jeff Lenning, CPA, CITP, of Seal Beach, Calif., heads a technology consulting firm. He is chairman of the California Society of CPAs Technology Committee, an instructor for the society's Education Foundation, and a frequent speaker on technological matters. Before founding his firm, Click Consulting, in 2000, he was a Big Five auditor and corporate financial analyst.

HIGHLIGHTS

The SEC extended by two months the comment period for its proposed road map for the adoption of IFRS for U.S. issuers. The comment period for the proposed road map, which was published Nov. 14, was originally scheduled to close Feb. 19. In a rule proposal, the SEC said the new deadline for comments is April 20.

A review of the comment letters published on the SEC Web site showed numerous requests for an extension of the comment period so that stakeholders would have more time to study the issues involved.

"This action will allow interested persons additional time to analyze the issues and prepare their comments," the rule proposal says. To comment or for more information, visit **www.sec.gov/spotlight/ifrsroadmap.htm**.

The deadline extension comes as Mary Schapiro takes control of the regulatory agency from former SEC Chairman Christopher Cox. In a Senate hearing prior to being sworn in, Schapiro expressed concerns with the SEC's current road map for transitioning U.S. public companies to IFRS. Schapiro pointed to potential problems including lack of consistency in the application of IFRS, the cost for U.S. companies to switch to IFRS from U.S. GAAP and the independence of the International Accounting Standards Board.

FASB released a proposal that would amend FASB Statement no. 107, *Disclosures about Fair Value of Financial Instruments*, to include disclosure requirements about the fair value of financial instruments in interim financial statements and in annual financial statements. The proposal also would amend APB Opinion no. 28, *Interim Financial Reporting*, to require those disclosures in all interim financial statements.

FASB described the changes as a way to address, in the interim, concerns raised about the lack of comparability resulting from the use of different measurement attributes for financial instruments. Board members decided that increasing the frequency of the disclosures about fair value would improve the transparency and quality of information provided to users.

Comments were due by March 2. The requirements would be effective for interim and annual reporting periods ending after March 15, 2009. The proposal does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The proposal is available at **http://tinyurl.com/d6wzkr**.

The AICPA Board of Directors in February extended Barry Melancon's term as president and CEO for an additional five years.

"Barry has made an enormous contribution to the CPA profession over the past 14 years, and the board is exceptionally pleased that he will continue to serve as president and CEO," Board Chairman Ernie Almonte said in a news release.

Almonte added that under Melancon's leadership, the AICPA has strengthened the profession's voice in public policy debates, fortified the profession's role in business, finance and capital markets, increased the number of accounting students, created centers for audit quality, implemented the computerized CPA exam, launched a national effort to address financial illiteracy and successfully relocated and streamlined its operations.

"It is a great honor to serve our 350,000 members," Melancon said in the release. "Our members collectively adhere to the highest standards of ethics and values, and being a part of the leadership team that works for them is a privilege. We have a tremendous team at the AICPA that strives every day to meet the needs of the CPA profession."

With 30 years of experience in the CPA profession, Melancon represents the Institute with state, national and international organizations. He also serves as the profession's leading advocate with national leaders, lawmakers and regulatory officials.

Prior to joining the AICPA as president and CEO in July 1995, Melancon served for eight years as executive director of the Society of Louisiana CPAs.

The Professional Accountants in Business Committee of the International Federation of Accountants has developed a sustainability framework. The Web-based framework tool is designed to support professional accountants and their organizations in integrating a sustainable way of thinking and working in all business processes. The framework illustrates how a commitment to sustainability can help improve an organization's products or services, motivate its people, lower its costs and enhance its reputation. The framework is available for free at **www.ifac.org/PAIB**.

The revised and updated version of GASB Concepts Statement no. 2, *Service Efforts and Accomplishments Reporting*, is now available for purchase. The statement was first issued in 1994. The revised statement includes amendments made to the document by GASB Concepts Statement no. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, and Concepts Statement no. 5, *Service Efforts and Accomplishments Reporting—an Amendment of GASB Concepts Statement no. 2*.

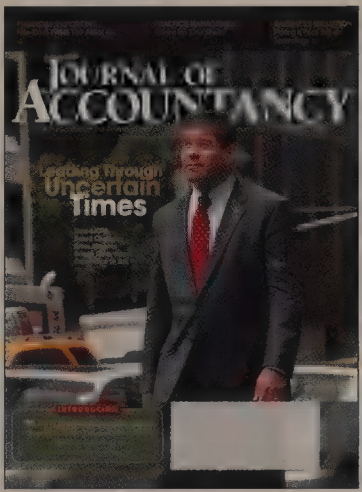
The revised concepts statement costs $19.50 and can be ordered at **www.gasb.org** or by calling 800-748-0659. ❖

LETTERS

NEW, NOT NECESSARILY IMPROVED

After reading the article "Shaking Up Financial Statement Presentation" (Nov. 08, page 56) and reviewing Exhibit 2, I am baffled as to how the new approach of netting assets and liabilities and separating the balance sheet into operating, investing and financing sections similar to the statement of cash flows is an improvement to the traditional A=L+OE method of balance sheet presentation. I am not sure what added value the user of such a statement will receive from netting assets and liabilities. The new presentation method seems to add confusion instead. The elementary task of checking total assets against total liabilities plus total equity seems to become a laborious process under the proposed model.

I do find added value in the separated operating, investing and financing categories, however. Yet, I propose that these figures be presented as footnotes to the financial statements and *not* incorporated into the balance sheet.



Arman Satchyan
Tujunga, Calif.

BACK TO THE FUTURE

The article "The Firm of the Future" (Nov. 08, page 68) suggests that time sheets and productivity tracking are relics of the past. However, the article actually shows time tracking and productivity management to be absolutely essential.

For instance, the Ohio firm cited requires 13.5 full-time equivalent employees to achieve $1.3 million in revenue. A firm with that number of employees should achieve close to $2 million of annual revenue. This example should certainly not motivate anyone to abandon productivity tracking. I can imagine why the employees are happy, but I don't understand why the partners are. My college production management professor back in 1983 stated, "Happy employees are not necessarily productive employees. Many employees are perfectly happy doing next to nothing."

Most current management experts, outside CPA practice management experts, teach that you get what you track. If you want productivity, you have to track productivity. The author would be much more convincing if more than only one of the top hundred firms had successfully adopted his model.

Frank Stitely, CPA, CVA
Chantilly, Va.

Author's reply: *The truthfulness of a theory is not determined by majority vote or by how many people are using it. The notion that the firm of the future theory is false because only one Top 100 firm is using it reminds me of those who didn't believe the Earth is round back when only a small minority believed it to be true.*

Today, more than 600 firms operate without time sheets, across all professional sectors—from accounting firms and advertising agencies, to IT, consulting and law firms. Some of these firms are in the top 1% of profitability in the world. Even if their level of profitability was the same, it seems obvious that most knowledge workers would rather work in an environment of high trust.

I was in college in 1983 as well, where I learned the same "happy employees are not necessarily productive employees" axiom. But the article wasn't about happy employees, it was about effective knowledge workers who are less effective when they are micromanaged and demoralized when forced to track every six minutes of their day.

Mr. Stitely claims "time tracking and productivity management to be absolutely essential." But the time sheet is not a measure of productivity since it is silent on output, results and value, being only a measure of input, activities and efforts. The firms in the article have replaced the time sheet with more effective Key Predictive Indicators that take into account output, results and value to the client, a far more effective tracking device that doesn't suffer from the illusion of control the time sheet provides.

Mr. Stitely further asserts "you get what you track. If you want productivity, you have to track productivity." This is nonsense. We don't change our weight by weighing ourselves more frequently or accurately. We must look at the root causes and processes, which time sheets emphatically do not do.

Most current management experts—including Peter Drucker, Gary Hamel, Stephen Covey, and H. Thomas Johnson, whose books I cited in the article—all agree that knowledge-worker productivity is very difficult to measure since we can't see what is going on inside people's heads. We have to discern it from the quality of their work, which requires another knowledge worker to make a judgment, not a measurement.

Ronald J. Baker
Petaluma, Calif.

Subject's reply: *One measurement does not establish the success of a firm. I did initially hesitate in sending in financial information for the article because we are in a period of transition, not just in how we operate, but from one generation to the next. Looking solely at revenue by FTE for one year does not reveal any of that.*

Is a firm with 13.5 FTEs that generates $2 million in annual revenue but has employees working 70 hours per week to get to that level of revenue better or worse than a firm that generates less revenue but does so without burning out employees? I don't believe there is a clear-cut answer to that, but I know which way I prefer. I like having self-motivated employees who enjoy a good living and have a balance in their lives.

The letter's author is suggesting that our revenue/FTE would change if we were keeping track of time and that the entire reason that metric is below his "industry norm" is because we're not keeping time sheets. To me, that thinking is flawed, and it's a reflection of what many in our

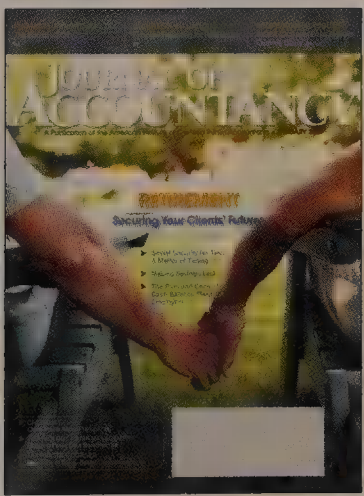
industry do (internally and externally): We look at one metric, out of context, and formulate an opinion without understanding what is going on behind the numbers. Does the letter's author know what that ratio was for our firm back when we billed by the hour? Does the author know whether it's an improvement? Does the author factor in economic and business differences between Lancaster, Ohio, and the Washington, D.C., area (which is where his firm is located)? Does the author explore the mix of services provided?

He also notes that if you want productive employees, you have to track productivity. This suggests that we can't have productive employees unless they jot down how they spend every minute of their day. That seems to be a very close-minded way of looking at productivity. If we monitor the work coming in and when it gets out, the satisfaction of our clients and staff, and the bottom line, what's to say our firm is less productive than another?

Victor Christopher, of Snyder & Co. CPAs
Lancaster, Ohio

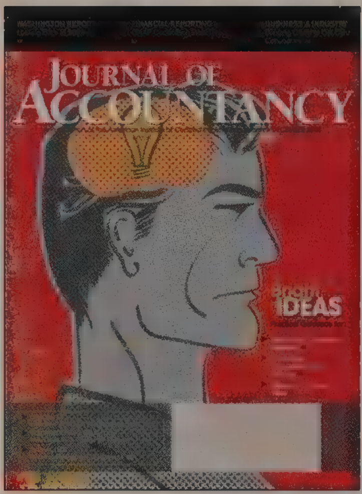
THE *OTHER* OTHER SIDE OF ANNUITIES

I just read the article "Annuities and the Other Side of the Retirement Savings Coin" (Jan. 09, page 36). The article discusses many of the benefits of annuities but does not seem to discuss in much detail the risks of purchasing an annuity, such as the risk of the insurance company becoming insolvent and the value of their "guarantee." My father recently told me that he invested all of his retirement into an annuity with a "guaranteed" return and therefore was not concerned about the recent downturn in the market. He did not disclose the name of the insurance company that sold him the annuity. What concerns me is that I do not know the financial health of the insurance company that is backing up the annuity. Although some of the principal may be guaranteed as required by various state laws, I fear that a significant portion of his retirement nest egg could be at risk of loss should the insurance company become insolvent.



Mark A. Norman, CPA
Grand Rapids, Mich.

Authors' reply: *If Mr. Norman's father purchased a fixed annuity, either immediate or deferred, the entire amount is backed by the insurance company's general assets and is at risk, as he fears. He should investigate the ratings and claims-paying ability of the company (start with the A.M. Best Co. rating service) and any state insurance guarantee program in the state where his father lives. Insurance companies are regulated by states, and fortunately, many were not deregulated to the extent of much of the rest of the financial services industry. If, however, his father purchased a variable annuity (which, from the brief description, seems to be the case), the underlying investments of the variable annuity funds are not subject to the solvency of the insurance company. The fate of the insurance company will affect only the guarantees offered in the contract (the "living benefits") and not the underlying funds.*



Richard E. Marcus, CPA, CFP, and Glen Janken, CFP, CLU
Los Angeles

INTERVIEW INSPIRES

"The Last Word" (Jan. 09, page 96) was great, inspiring me to keep growing and to not forget those who helped me along the way. Kudos to Ms. Evans and to the writer.

Well done.

Scott Blassingame, CPA, CPE
Tupelo, Miss.

ALPHABET SOUP

The article "On the Verge of an Academic Revolution" (Dec. 08, page 82) did a fantastic job of outlining the challenges facing educators as a result of looming U.S. convergence with IFRS. One important issue for educators that was completely ignored, however, was how to pronounce the overwhelming plethora of new acronyms introduced with international standards. Little to no guidance can be found in this area, and the problem is ubiquitous. No longer do we simply have the FASB and GASB. Now we have the unpronounceable IASB. Do we say, "Eye-Azby"? Or is it "Yazby"? We need to know because no one wants to look stupid in front of the French. Also, how is the IASB distinguishable from the IAASB? If the former is pronounced "Eye-Azby," does the latter have a karate-style "Ai-Yaw!-Azby." Then consider IFRS. I have heard this pronounced both "Eye-Furs" and "If-Wris." Since it is difficult to know which countries have adopted them—and to what extent—maybe they should be pronounced "Iffers." And we haven't even touched the IPSASB, IFAC or IASCF.

The problem reaches far beyond international acronyms. Everyone is frustrated with the PCAOB. It certainly doesn't roll off the tongue when spoken as a list of initials; however, I don't want to call it the "Pi-Cowb." That's the universal sound effect for a laser gun. Some members of our profession have bestowed upon the PCAOB the far-too-cutesy nickname "Peek-a-Boo." And I don't have the space here to explore the problems with the TIGTA, FinCEN or the CAQ.

Greg Kyte
Provo, Utah

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topline

News, People, Trends and Other Noteworthy Items

TONE AT THE TOP

And You Thought *Your* Boss Was Bad

One boss took a bite of someone's doughnut while they were away from their desk, another showed everyone a kidney stone he had passed, and a third declared "Talk Like a Pirate Day."

While these might sound like scenes from the TV show *The Office*, they all really happened, according to a CareerBuilder.com survey about bad boss behavior.

In response, CareerBuilder.com developed a free Web site that lets workers who are dealing with problem bosses provide them constructive criticism, or just fun advice, anonymously. The site, **www.anonymoustipgiver.com**, allows users to select from one of four outlandish characters and several unique voices to deliver a custom message, which is delivered by e-mail.

CareerBuilder.com's survey found women (48%) are more likely to quit because of a bad boss than men (39%). Age also plays a role in who stays and who goes. Approximately 48% of workers ages 35 to 44 left their jobs because of a bad boss, while 40% of younger workers, ages 18 to 24, and 41% of older workers, ages 45 to 54, said they quit.

Source: CareerBuilder.com, **www.careerbuilder.com**.

SIGN OF THE TIMES

U.S. Pastures Not Looking as Green to Renewable Energy Investors

The economic downturn has caused the United States to lose its clear leadership position as the best country in which to invest in renewable energy, allowing Germany to tie it for first place, according to an Ernst & Young study.

E&Y's latest *Renewable energy country attractiveness indices*—which track and score global investment in renewable energy—also reveal a record reduction in the attractiveness of all 20 countries included for the first time since its creation five years ago.

"Although the financial crisis has negatively impacted the attractiveness of all countries in the indices, the U.S. has borne the brunt of the economic slowdown," Jonathan Johns, head of renewable energy at E&Y, said in a news release.

In particular, the study found that the U.S. slowdown has restricted access to finance and slowed the recycling of production tax credits and investment tax credits, which allow businesses to gain tax breaks by purchasing credits from renewables developers.

Source: Ernst & Young, **www.ey.com**.

TONE AT THE TOP

Investors to Hedge Funds: Show Me the Money (and How You Got It)

Institutional investors appear committed to hedge fund investing, but fund managers will face wider-ranging and more in-depth scrutiny, according to a survey by SEI and Greenwich Associates.

Hedge funds fulfilling performance expectations and embracing transparency will retain and capture assets, the survey found. The need for greater transparency and enhanced client reporting and communications from hedge fund managers was brought on by the worst year on record for hedge fund performance, according to an SEI news release.

SEI collaborated on the survey with Greenwich Associates, initially polling institutional investors in Continental Europe, the United Kingdom and the United States at the end of August. The firms re-interviewed respondents in November as the financial crisis deepened to help gauge the impact of market turmoil on institutional attitudes and plans concerning hedge funds, the release said.

While portfolio transparency was named by just one out of four institutions as a "very important" selection factor in the first-round survey, investors named portfolio transparency as the No. 1 investment criteria demanding more weight in the second survey.

Source: SEI, **www.seic.com/ims/underthemicroscope.**

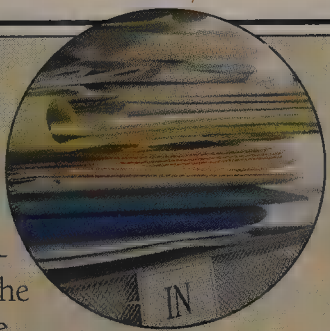
DATA POINT

189 million

The approximate number of callers to the IRS' toll-free telephone help lines during fiscal year 2008.

Source: TIGTA report on IRS call volume, **www.treas.gov/tigta/auditreports/2009reports/200940030fr.html.**

AS QUOTED



"By having independent budget authority like the banking regulators, the SEC would have greater control over its own budget and funding levels, allowing the agency to take steps to address its growing workload in an increasingly complicated marketplace, while also recruiting and maintaining quality staff."

—SEC Commissioner Luis A. Aguilar in remarks at the Investment Company Institute's Board of Governors' meeting Jan. 26.

Source: SEC, **www.sec.gov.**

TECH TALK

Security Issues Top List of Technology Concerns

Considering the fact that much of the data used by CPAs is personal information, it's no surprise that security issues top their list of concerns when it comes to technology, according to the AICPA's 20th annual *Top Technology Initiatives* survey.

For the seventh consecutive year, participants rated "information security management" the most important issue affecting businesses' IT strategy, investment and implementation in the coming 12 to 18 months.

Also underscoring the importance of security, "privacy management" moved up from fourth to second place on this year's list, and "secure data file storage, transmission and exchange" came in at No. 3, the first time it has appeared on the list.

Following is the complete list for 2009:

1. Information security management
2. Privacy management
3. Secure data file storage, transmission and exchange
4. Business process improvement, workflow and process exceptions alerts
5. Mobile and remote computing
6. Training and competency
7. Identity and access management
8. Improved application and data integration
9. Document, forms and content knowledge management
10. Electronic data retention strategy

Source: AICPA, **www.aicpa.org/toptech.**

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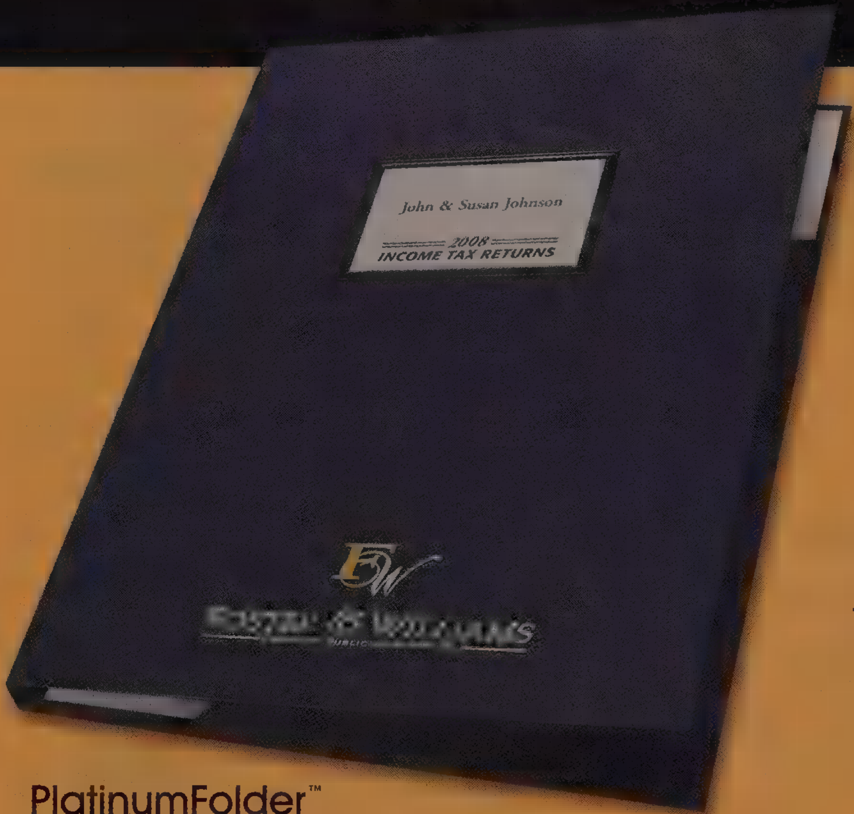

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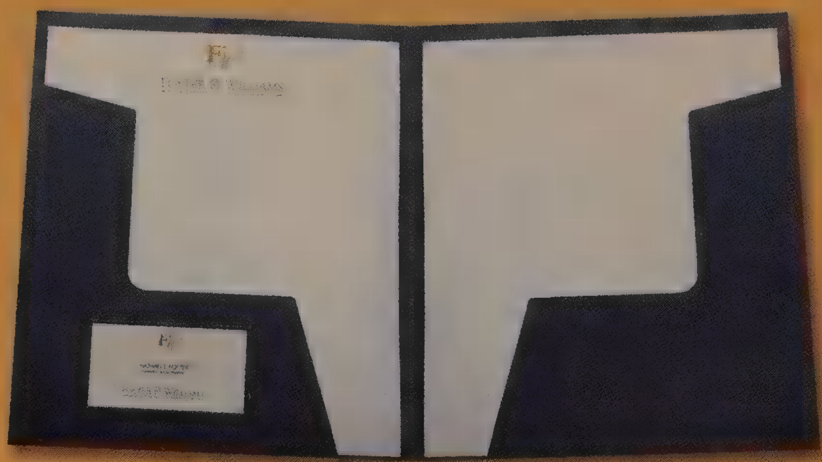

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Journal of Accountancy News Digest

AUDITING

■ To help auditors, management and others involved with gauging the effects of the economic crisis on an entity's viability and whether these effects should be described in the financial statements, the International Auditing and Assurance Standards Board (IAASB) released the practice alert *Audit Considerations in Respect of Going Concern in the Current Economic Environment*.

The alert highlights areas within International Standard on Auditing (ISA) 570, *Going Concern*, as well as other ISAs that are particularly relevant in the current economic environment and provides additional guidance for auditors in evaluating management's use of the going concern assumption. It also discusses issues surrounding liquidity and credit risk that may create new uncertainties for entities or exacerbate existing ones.

James Sylph, executive director, professional standards, for the International Federation of Accountants (IFAC), the IAASB's parent organization, said in a statement that evaluating going concern will "take on even more importance and is likely to be more complex. This is particularly the case with regard to the availability of credit and the impact of the current economic environment on budgets and forecasts."

The alert follows the IAASB's October 2008 release of *Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment*. Both alerts are available at **www.ifac.org/financial-crisis**.

The AICPA also released guidance designed to provide auditors of financial statements with an overview of their responsibilities under AU section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. The information is available on the AICPA's Economic Crisis Resource Center Web site, **http://economy.aicpa.org/**. The going concern guidance is part of the AICPA Audit Risk Alert, *Current Economic Crisis: Accounting and Auditing Considerations*. The full risk alert is available at **www.cpa2biz.com**.

■ The PCAOB published Staff Views, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies*. The guidance explains how auditors can apply the principles in Auditing Standard no. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, to audits of smaller, less complex public companies. AS5 provides direction to auditors on scaling an audit based on the company's size and complexity. The revisions, made to the preliminary guidance that was issued for public comment and are discussed in Appendix B, were made to enhance or clarify the final guidance. The document is available at **http://tinyurl.com/b8j5ts**.

■ The AICPA released for exposure certain risk assessment standards rewritten as part of its clarity project. The proposed risk assessment standards have been redrafted into a format that clearly identifies objectives, relevant definitions, requirements, and application and other explanatory material.

The clarified risk assessment standards released for exposure supersede SAS no. 106, *Audit Evidence*, SAS no. 107, *Audit Risk and Materiality in Planning an Audit*, SAS no. 108, *Planning and Supervision*, SAS no. 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Redrafted), and SAS no. 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted). The exposure documents are available at **http://tinyurl.com/asq23v**.

The clarity project is similar to one recently completed by the IAASB that aims to clarify its ISAs. The AICPA's Auditing Standards Board developed a plan to converge U.S. GAAS with the ISAs while avoiding unnecessary conflict with PCAOB standards.

BANKING

■ The FDIC's board of directors, as required by the Government Performance and Results Act, released its *FDIC Strategic Plan, 2008–2013*. The latest release supersedes the *FDIC Strategic Plan, 2005–2010*, which was approved in 2005.

The plan includes the FDIC's long-term strategic goals and objectives for carrying out its core mission to insure depositors, supervise insured institutions, and resolve the failure of insured institutions. The corporation's major strategic goals are:

■ Protecting insured depositors from loss without recourse to taxpayer financing.

■ Keeping FDIC-insured institutions safe and sound.

■ Visit **www.journalofaccountancy.com** for news updated daily, and to sign up for e-mail news alerts on topics of your choice.

FDIC's Supervisory Mission

The Supervision Program, under which the FDIC promotes and regulates the safe and sound operation of more than 5,000 banks, is one of the agency's three major programs. But the FDIC also has backup supervisory responsibility for other institutions over which other federal agencies have primary responsibility.

Primary Federal Regulator	Number of Institutions	Total Assets
FDIC	5,163	$2.26 trillion
Office of the Comptroller of the Currency	1,585	$7.92 trillion
Federal Reserve System	874	$1.55 trillion
Office of Thrift Supervision	829	$1.57 trillion

Source: *FDIC Strategic Plan, 2008–2013*, **www.fdic.gov**. Data are as of June 30, 2008.

- Ensuring that consumer rights are protected and that FDIC-supervised institutions invest in their communities.
- Ensuring that resolutions are orderly and receiverships are managed effectively.

The *FDIC Strategic Plan, 2008–2013* can be downloaded at **www.fdic.gov**.

FINANCIAL REPORTING

■ FASB issued a proposal intended to improve financial reporting by resolving some potential ambiguity about the breadth of the embedded credit derivative scope exception in Statement no. 133, *Accounting for Derivative Instruments and Hedging Activities*. The proposal would amend certain accounting and reporting requirements of paragraph 14B of Statement no. 133 to clarify when embedded credit derivative features, including those in collateralized debt obligations (CDOs) and synthetic CDOs, are not considered embedded derivatives subject to potential bifurcation and separate accounting. Comments on the proposal were due Feb. 13. The proposal is available at **www.fasb.org/derivatives/01-14-09_C22.pdf**.

INTERNATIONAL

■ The Trustees of the International Accounting Standards Committee (IASC) Foundation, the oversight body of the International Accounting Standards Board (IASB), announced constitutional changes that address recommendations made in comment letters from numerous stakeholders, including the AICPA, as well as those made by G-20 leaders at the group's November summit in Washington, D.C.

The constitutional amendments are intended to enhance public accountability by establishing a link to a monitoring board of public authorities, according to an IASC Foundation press release. The IASB will be expanded from 14 to 16 members by 2012, with criteria added to ensure geographical diversity. Core standards will also be made available for free through a Web site, and the IASC Foundation has pledged to work more closely with investors through a regular liaison with a wide range of investor groups represented in the reconstituted Standards Advisory Council.

The monitoring board will comprise leaders from the Emerging Markets and Technical Committees of the International Organization of Securities Commissions (IOSCO), the European Commission, the Japan Financial Services Agency and the U.S. SEC. For more information, visit **www.iasb.org.**

■ The International Accounting Education Standards Board (IAESB), an independent standard-setting board within IFAC, proposed a revised framework for International Education Standards (IES).

The proposed framework consists of two parts. Part one explains the educational concepts of competence, initial professional development, continuing professional development, and measurement of the effectiveness of learning and development, which the IAESB will use when developing IES. Part two describes the nature of IES as well as the related IAESB pronouncements and IFAC member body obligations.

The framework is targeted primarily to IFAC member bodies that have direct or indirect responsibility for the learning and development of their members and students.

Comments are due April 30. The exposure draft can be viewed at **www.ifac.org/EDs**.

PENSIONS

■ The Pension Benefit Guaranty Corp. (PBGC) released the *Pension Insurance Data Book 2007*, which contains statistical trends related to defined benefit retirement plans in the private sector. The *Data Book* also contains a feature article examining standard terminations, the most common procedure used to end PBGC-insured single-employer defined benefit plans.

In a standard termination, the plan sponsor opts to end a plan with assets sufficient to pay all benefits earned by those enrolled. This is done by purchasing annuities for participants and beneficiaries from a private-sector insurance company or, if the plan permits, making lump-sum payments.

In fiscal year 2007, 1,225 single-

employer plans—4% of all existing plans at the beginning of the year—ended in standard terminations. In the same period, the PBGC took over 110 insolvent plans. Most of the plans that ended in a standard termination were small plans—75% had fewer than 25 participants, while more than 90% had fewer than 100 participants.

The *Data Book* contains detailed statistics, graphs and tables on the financial conditions of the PBGC's two programs covering single-employer plans and multiemployer plans. It contains other vital statistics such as the number of people and plans protected by the programs, the people receiving or eligible to receive benefits from the PBGC and benefits paid to them, and claims against the programs.

The *Data Book* is available at **www.pbgc.gov/docs/2007databook.pdf**.

REGULATION

■ The Government Accountability Office released a report that provides a framework for reforming the U.S. financial regulatory system. *A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System* was drafted with input from 29 agencies and other organizations, including federal and state financial regulatory agencies, consumer advocacy groups and financial services industry trade associations.

The introduction to the report cites several major changes in financial markets that have highlighted gaps in the existing regulatory system, including:

■ The failure of regulators to mitigate systemic risks by large and interconnected financial conglomerates.

■ The inability to address problems caused by large and sometime less-regulated entities such as nonbank mortgage lenders, hedge funds and credit-rating agencies.

■ The increasing prevalence of new, more complex investment products, in particular the increasingly complex mortgage and retail credit products that have particularly vexed consumers.

■ The growing challenges to accounting and financial regulators to respond to market developments, including the pending global convergence of accounting and auditing standards.

■ Amid the globalization of markets, the nation's fragmented regulatory structure has hampered its ability to coordinate effectively internationally with other regulators.

The report sets out a framework for Congress to shape regulatory reforms. The complete report is available at **www.gao.gov/new.items/d09310t.pdf**.

■ Mary L. Schapiro was sworn in Jan. 27 as the 29th chairman of the SEC. Schapiro was appointed by President Obama on Jan. 20 and unanimously confirmed by the Senate. She is the first woman to serve as the agency's permanent chairman.

Schapiro previously served as a commissioner at the SEC from December 1988 to October 1994. She was appointed by President Reagan, reappointed by President George H.W. Bush in 1989, and named acting chairman by President Clinton in 1993. She left the SEC when President Clinton appointed her chairman of the Commodity Futures Trading Commission, where she served until 1996. Immediately prior to her current SEC appointment, Schapiro was CEO of the Financial Industry Regulatory Authority.

SMALL BUSINESS

■ The U.S. Small Business Administration is offering free online training courses and other resources to assist small businesses in more effectively managing their firms in the current slow economy.

Courses are available at **www.sba.gov/services/training/onlinecourses**. The courses cover issues such as revising business plans to reposition with current conditions, winning customers in a slowing economy, restructuring existing debt, and diversifying a customer base with federal contracts. The most recently added course, "Downshifting in a Slowing Economy: A Business Planning Guide," is designed to help business owners reorganize and streamline their business strategies.

The SBA also has free economic recovery resources available at **www.sba.gov/helpingmainstreet**. The Economic Recovery page includes resources on training, loan programs and mentoring. ❖

Small Business Outlook

As small businesses struggled with the deteriorating economy at the end of 2008, their confidence about the next few months sank. In December, the National Federation of Independent Business's monthly "Index of Small Business Optimism" fell to its lowest level since 1980. Plans for capital expenditures are one component of the index, and they sank to their lowest level since the mid-1970s.

Percent Planning a Capital Expenditure During the Next Three to Six Months

	March	June	Sept.	Dec.
2003	27	28	26	38
2004	35	28	32	38
2005	36	33	31	33
2006	31	27	30	26
2007	33	28	29	30
2008	25	26	21	17

Source: NFIB Small Business Economic Trends, January 2009, www.nfib.com

CHECKLIST

A Path to Financial Stability

A sound business strategy is important no matter what the state of the economy. As you work with clients to determine the best methods of surviving the recession, be sure to discuss the following critical points for seizing opportunities to refocus, contain expenses and reassure customers.

✔ ***Take a fresh look at your budgetary and revenue needs.*** Are you meeting budgeted projections? How much of a drop in revenue can your business withstand and for how long? What are your cash-flow needs for the next 90 to 120 days? Or 120 to 180 days? Do you have sufficient cash reserves for the next 30 to 60 days?

✔ ***Check with your lenders on the status of your credit lines.*** Are you in compliance with their terms? Will your bank renew their commitments at similar amounts, rates and terms? If your credit lines are frozen or at their limits, consider meeting with vendors to work out a payment schedule that will allow continued delivery of critical materials and supplies.

✔ ***Look into alternative types of financing.*** Consider loans on life insurance policies and loans from key customers that rely on your business for their materials and supplies or from labor unions, local development agencies or the U.S. Small Business Administration.

✔ ***Keep an eye on accounts receivable and the amount of credit extended to customers.*** Watch for new patterns of slow payments and follow up immediately. Review your largest and riskiest accounts to determine if credit constraint or an economic slowdown will affect their ability to pay you. Keep receivables aging current.

✔ ***Closely manage accounts payable.*** Forfeiting early pay discounts may be more advantageous in preserving cash that may be needed for critical items. Keep payables aging current.

✔ ***Monitor inventory levels in general to identify where lower inventory levels of materials and products can be maintained.*** Consider selling slow-moving inventory at a discount. Keep in contact with suppliers to co-manage replenishment and delivery schedules to avoid building excess inventory while at the same time avoiding shortages that could result in lost revenue.

✔ ***Analyze your expenses specifically to determine if spending can be reduced.*** Communicate to staff/team members about tightening spending. Manufacturers should review inventory management practices for opportunities to reduce on-hand inventory. Service companies should ensure they're capturing all their billable hours and invoicing promptly by billing all contractual items and pass-through expenses (that is, billable third-party services and travel and living expenses).

✔ ***Don't engage in panic selling of investments.*** Keep in mind that markets tend to bounce back. Focus on long-term rewards instead of reacting emotionally to short-term events. Contact your financial adviser to ensure that your portfolio is diversified and meets your risk tolerance.

✔ ***Contact your good customers.*** Even casual discussions can lead to new business opportunities. Maintain constant communication with customers to help build stronger relationships; let them know you are available even during uncertain times. Consider ways to stay visible to customers, such as an open house or other marketing efforts.

✔ ***Going forward.*** Continually re-evaluate and gauge your company's current situation and the marketplace. Revisit this checklist often, stay the course and remain focused on goals. Keep track of efforts, and review and analyze the results. Identify areas where strategies are not working and modify accordingly.

—Adapted from the AICPA Private Companies Practice Section (PCPS) client credit crisis communication letter. It is available on the Web at ***http://pcps.aicpa.org/Client+Credit+Crisis+Communication.htm.***

Keeping It Together

Plan the transition to retain staff and clients

by Joel Sinkin and Terrence Putney

Retirement, health issues for an owner, the desire to grow—all of these are reasons firms engage in mergers or acquisitions. Most firms decide to merge or acquire only after considerable analysis of financial and professional outcomes. Last month we gave general advice for ensuring a merger or acquisition goes smoothly. But a firm's ability to make a successful deal depends not only on deal structure and due diligence but also on the successor firm's ability to retain clients and staff. Unfortunately, an agreement between the partners of two firms to combine has nothing to do with whether staff and clients stay or leave.

This article looks at the challenge of retaining clients and staff immediately after the merger. Retention should be addressed through a properly designed and executed transition plan, which should be divided into two retention sections: clients and staff.

Client Retention

A client generally selects a firm based on chemistry between the client and the accountant, location of the firm's office, cost and perceived value of services, professional expertise, and trust. The announcement of the merger/acquisition deal may force clients to deal with the broad concern, "Will my relationship with the firm change?" More specifically, their worries relate to the reasons they selected the firm:

- "Will the partner I have been dealing with still be there?"
- "Will my fees increase?"

■ "Will the staff I am used to dealing with and procedures I am accustomed to working with remain the same?"

■ "Will the firm's location still be convenient?"

Addressing these concerns is critical to client retention. The message you deliver in the merger/acquisition announcement must speak to the issues—and at the same time reinforce the reasons clients initially chose your firm over others. Whenever possible, when you inform clients about the transaction, reassure them that the things they depend on will not change; emphasize continuity regardless of what is changing; focus on things that are not changing; and stress what the client is gaining rather than losing.

Your client transition plan should list action steps in these areas:

1. ***Timing of the announcement.*** Decide when various clients should be told of the transaction. Generally, all clients should receive a formal announcement fairly close to when the news becomes public to assure they are given the information they need so they will support the deal. How and when you make the announcement, however, depends on the importance of the client to the firm and the amount and timing of interactions with the client.

Your best clients (usually measured by size of annual fees, or importance to the firm in other ways such as a referral source or stature in the community) may be told about the pending combination before it is consummated. If your firm has a number of annual clients (such as individual tax clients), consider waiting to tell them about the deal until close to the time of their annual visit to the firm (for example, when tax organizers are sent out). This approach minimizes the time during which clients may make assumptions about what the combination means to them and consider an alternative to their current service provider. This technique works best when the business combination will not likely become generally well-known for these clients.

2. ***The message.*** Whether you communicate with clients in person, by letter, or by phone, make sure you send a consistent, positive message about the transaction (for sample letters, see the online version of this article at **www.journalofaccountancy.com**; enter code 20081182 in the search box). To assure consistency, some firms draft scripts for staff to use as they talk to clients.

Focus the message on how the merger/acquisition benefits the client. The initial announcement might say: "We are merging with Smith and Jones to provide our clients with new areas of expertise and access to more resources." Promote the new or specialized services the acquired firm offers. Additionally, include in the announcement reassurances of things that will *not* change—especially staff, fee structure and client services, which are all key concerns.

How and when you address the concerns of both clients and employees affect a merger's success.

Is the combination deal a merger/acquisition, or is it a purchase? In your communications with clients, the press and staff, avoid the term "purchase." Clients do not like to think they have been "sold." Even if the firm is purchased from an estate of a deceased practitioner, call the transaction a merger or an affiliation.

3. ***Deciding how to deliver the message.*** The importance of the client will dictate how the announcement is made as well as when it is made. For example, a personal visit by the partner in charge of the account is the best way to convey the information to important clients. If that is not possible, the partner should at least make a phone call. This allows the messenger to respond to questions immediately and reinforces the client's importance to the firm.

Clients who are scheduled to be seen in the near future can be told in person

Focus on Continuity of Service

Continuity of service is critical to retaining clients. Make the transition transparent by:

■ ***Retaining contact information.*** Keep phone and fax numbers, domain names and e-mail addresses for at least a year. Answer the acquired firm's phone number on a dedicated line with a custom greeting that uses both firms' names.

■ ***Maintaining service and billing methods.*** Don't immediately change work processes and billing systems. Wait until clients are comfortable with the new firm.

EXECUTIVE SUMMARY

■ **When a merger or acquisition takes place,** clients are chiefly concerned about who their accountant will be, if their fees will change, and if the office location will be convenient.

■ **Top staff worries include job security,** changes in compensation and benefits, and restrictive employee agreements.

■ **A smooth transition that results in** retained clients and staff carefully addresses all concerns.

■ **In the initial stages of the transition,** care should be taken to make changes slowly so clients and staff can become acclimated to the new firm's operations.

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Case Study: A Successful Long-Distance Transition

Larry, age 62, intended to sell his practice in three years, but his wife's health precipitated an early move across the country to Arizona. He wondered how he could sell his $300,000 personal tax-return practice when he couldn't personally serve his clients. Good planning salvaged the situation and retained his clients.

Larry merged his practice with Michael's firm, which was very similar in operational style and expertise. They created a new entity with both their names in the firm name.

Larry sent out a merger announcement letter emphasizing Michael's expertise and explaining that Larry would brief Michael on each client's needs. Michael would interview clients to find ways to reduce taxes; they would both review the return. Fees would not change, and Larry would remain the lead partner on the account.

Larry called each client from Arizona and scheduled the meeting. Michael completed the returns and sent them to Larry to review. Larry called each client to review the return. If a client called Michael with questions for Larry, Michael called Larry. Larry called back the client, listened to the questions, then responded, "Let me discuss this with Michael and get back to you with our joint opinion; Michael will call with the answer."

With this process, clients became used to working with a new accountant, and the result was almost 100% client retention.

Case Study: Transitioning Over Time

Each of two equal partners in a $1.7 million firm had sights on retiring—David in two years, Martha in four. The firm, which employed two CPAs, one paraprofessional, and one clerical person, had a profit margin of 40%. The firm reached an agreement with a successor firm that had excess staff and office capacity and a similar operating style. Client retention was high because of the way the transition was managed.

An initial announcement letter was sent to the clients emphasizing the gain the clients would experience from the talent of the new firm and the continuity the combined firm would offer.

David and Martha would each receive compensation equal to 20% of the collections from all of their original clients, consistent with their current profitability (including the cost of perks and benefits). If they needed labor in addition to what was used in the past, they would pay the successor firm 67% of the normal billing rate for the excess labor.

At the end of the second year, David would retire and start to receive his share of the payout over the subsequent five years. At the end of the fourth year, Martha would retire and start to receive her share of the payout over the subsequent five years.

This transition allowed clients to acclimate gradually to the successor firm. Starting immediately for David and in the final two years for Martha, clients were seen in person on an alternating basis by the original partner alone and then by the original partner and the successor partner jointly. By the time David and then Martha retired, clients were comfortable with the successor. No further announcement was required. The transition was completed fully, and the client-retention risk of the buyout was effectively eliminated.

as those meetings occur. Send a letter or an e-mail to clients who are less critical to the firm's success. Do this, however, prior to a public announcement made through a press release.

4. ***Introduction of the successor.*** A personal introduction of the successor to the client helps assure an effective transition. It also helps prevent the client from praising the merger but warning that the existing partner must remain in charge. (A client is unlikely to say to your successor, "Nice to meet you, but don't come back.")

If the business combination is occurring for reasons other than succession, it is not critical to take along or otherwise introduce the client to anyone in the new firm. However, if the plan is for the partner in charge to phase out (even over the next few years), that process is best started with the announcement meeting. You can introduce a successor as "backup" or additional support if the transition will be occurring over time.

In addition to introducing the successor, defer to him or her whenever possible. For example, a client may call you (the partner who is transitioning) with a question or problem. Instead of responding as usual, yield to your successor. Allow him or her to return the call. This action supports the transition and shows that the successor is taking a sincere interest in the client. If you continue to answer every question, the relationship will not transition, and client retention will remain at risk.

5. ***Involvement of both firms in the communication process.*** Little things can make a difference in perception. For example, mailing the announcement letter in the predecessor's envelope but writing it on the successor firm's letterhead ensures the letter will be opened and sends a powerful but subtle message about the transition.

6. ***Time commitment of the seller to the transition.*** Sellers seeking to leave soon after the acquisition understand their presence is necessary for a successful transition, but they wonder how long they will have to continue working.

It is not the number of hours spent

Case Study: A Merger Resulting in Lost Clients

In this case a $2.7 million firm with three equity partners was merged into a regional firm. Two partners intended to remain in the successor firm long term. The third, John, was to stay for three years and then be bought out. In this case, 20% of clients were lost when John retired.

The firms in this case did not have a plan to transition clients. During the three years he remained on the job, John handled all his clients as usual, answered all their questions himself, and never actively got the successor firm involved with the clients.

The substantial loss of clients affected John's buyout payments as well as the firm's profitability because his buyout was tied to client retention during the first two years following his retirement.

with clients but the message sent to them that matters the most. For example, if you are a retiring practitioner, consider the amount of time you physically spend in front of clients. Often, it is no more than 200 to 300 hours per year, with the remaining "client service" time spent behind the scenes preparing, reviewing and supervising work.

Therefore, if you spend the same time seeing clients and remaining available for consultation via phone and e-mail, the clients may perceive no difference in the relationship. Planning an appropriate amount of "face time" allows for the transition of most of that practitioner's client service responsibilities.

Staff Retention

Most staff members have never been through a merger or acquisition. Their perspective is blurred by media reports about large mergers and acquisitions that focus on cost cuts and staff reductions. Furthermore, the prospect of a merger or acquisition holds the specter of significant change, and many people are uncomfortable with change.

The keys to retaining staff are minimizing change, giving them a clear picture of why they will benefit from the combination, and providing constant communication. Effective staff-retention strategies address upfront concerns about job security, compensation and benefits, and employee agreements.

No simple solutions can eliminate all of these fears, but one of the most effective actions is clear and frequent two-way communication in which you share your firm's vision and ask for (and listen to) their opinions. These actions create an environment in which staff feels someone is listening, they have input, and their opinion counts.

Plan and execute your staff-retention plan carefully. Address basic concerns by taking these steps:

1. ***Inform the most senior staff members first.*** When it is possible to do so (considering the risk involved), announce the pending business deal to them before the deal closes. This reinforces these staff members' importance to the firm.

2. ***Make firsthand announcements.*** Do not let the staff find out about a merger or acquisition from an announcement meant for clients and the public. Tell them in person.

3. ***Send an upbeat and positive message.*** Reinforce that the deal is not a threat to staff and emphasize the things that will *not* change. Remember that the topmost question of staff members is, "Will I have a job after the merger?" If you have no intention of reducing staff, reassure them with the simple message—sent to both sides in the deal—"You are welcome and coveted."

4. ***Tackle the issue of compensation and benefits.*** Another concern staff members have is the deal's effect on compensation. The merging companies will almost certainly have different compensation programs. As your firms become one company, try to keep compensation at historical levels, even if existing levels at one company are not totally in sync with targets.

Forcing pay cuts to bring people into line is a surefire way to run them off. A better approach to bringing salaries in line is to freeze compensation at existing levels and let natural attrition and time gradually bridge the gap.

The same applies to benefit plans. If the acquiring firm's plans, such as health insurance cost sharing or paid time off, are not as generous as those provided by the old firm, one method to bridge the gap is to compensate for the loss of these benefits with a cash adjustment. The cost of attrition often far outweighs the minimal cost of keeping people whole (which actually costs nothing compared to the predecessor's historical cost structure). Also indicate how the transaction will affect perks.

5. ***Address employment agreements.*** New employment agreements are often a necessary part of a transition. But staff may view the restrictive covenants in these agreements as a negative. Present the agreements as a way to promote security and certainty. This focus will help retain staff and still protect the business.

6. ***Clarify reporting relationships.*** Describe what the transaction means to staff in terms of their roles, the management structure (and how they fit into it), and office facilities.

7. ***Talk about career opportunities.*** The firm's most motivated staff, the people who count on long-term career growth, may assume the transaction will limit their opportunities. If the deal presents a good

opportunity for their careers, be clear about how growth can occur.

8. ***Orient new employees.*** Remember that employees of the acquired firm are new. Distribute employee handbooks; obtain signed agreements; conduct training on all major systems such as time and billing and tax prep software; and consider holding a get-acquainted event for the employees of both firms.

9. ***Maintain an open dialogue.*** Give staff a way to ask questions and explore what the merger or acquisition means for them after the deal is consummated. Provide opportunities for one-on-one conversations by assigning a "go-to" person with whom staff can work. Small firms may designate one individual as a go-to person. Larger firms may consider assigning the role to several individuals—one for each category of employees, such as managers, senior staff and junior staff. ❖

AICPA RESOURCES

JofA articles

- "Mergers & Acquisitions of CPA Firms," March 09, page 58
- "Securing Succession Success," Dec. 07, page 34
- "Two-Stage Deals," March 06, page 43
- "Price Equals Value Plus Terms," Dec. 04, page 67

CPE

- *Mergers, Acquisitions and Sales of Closely Held Businesses: Advanced Case Analysis*, a CPE self-study course (#732863)
- *What You Need to Know About Accounting for Business Combinations*, a CPE self-study course (#182000)

Publications

- *Adviser's Guide to Mergers, Acquisitions, and Sales of Closely Held Businesses* (#091027)
- *Compensation as a Strategic Asset* (#090493)
- *Securing the Future: Building a Succession Plan for Your Firm* (#090486)

For more information or to place an order, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

Private Companies Practice Section

The Private Companies Practice Section (PCPS) is a voluntary firm membership section for CPAs that provides member firms with targeted practice management tools and resources, as well as a strong, collective voice within the CPA profession. Visit the PCPS Firm Practice Center at **www.aicpa.org/PCPS**. For additional resources on succession planning and successful staff management, visit the PCPS Success Planning Resources Center at **http://pcps.aicpa.org/Resources/Succession+Planning** and the PCPS Human Capital Center at **http://pcps.aicpa.org/Resources/Human+Capital+Center**.


Get the IRS to pay You
Visit www.tax-whistleblower.com
The IRS' new tax whistleblower statute gives anyone with information about large-scale tax underpayments, relating to any issue from mere errors to aggressive positions to tax fraud, an incentive to report it.
We have over $15 billion in confidential tax whistleblower submissions to the new IRS Whistleblower Office.
THE FERRARO LAW FIRM
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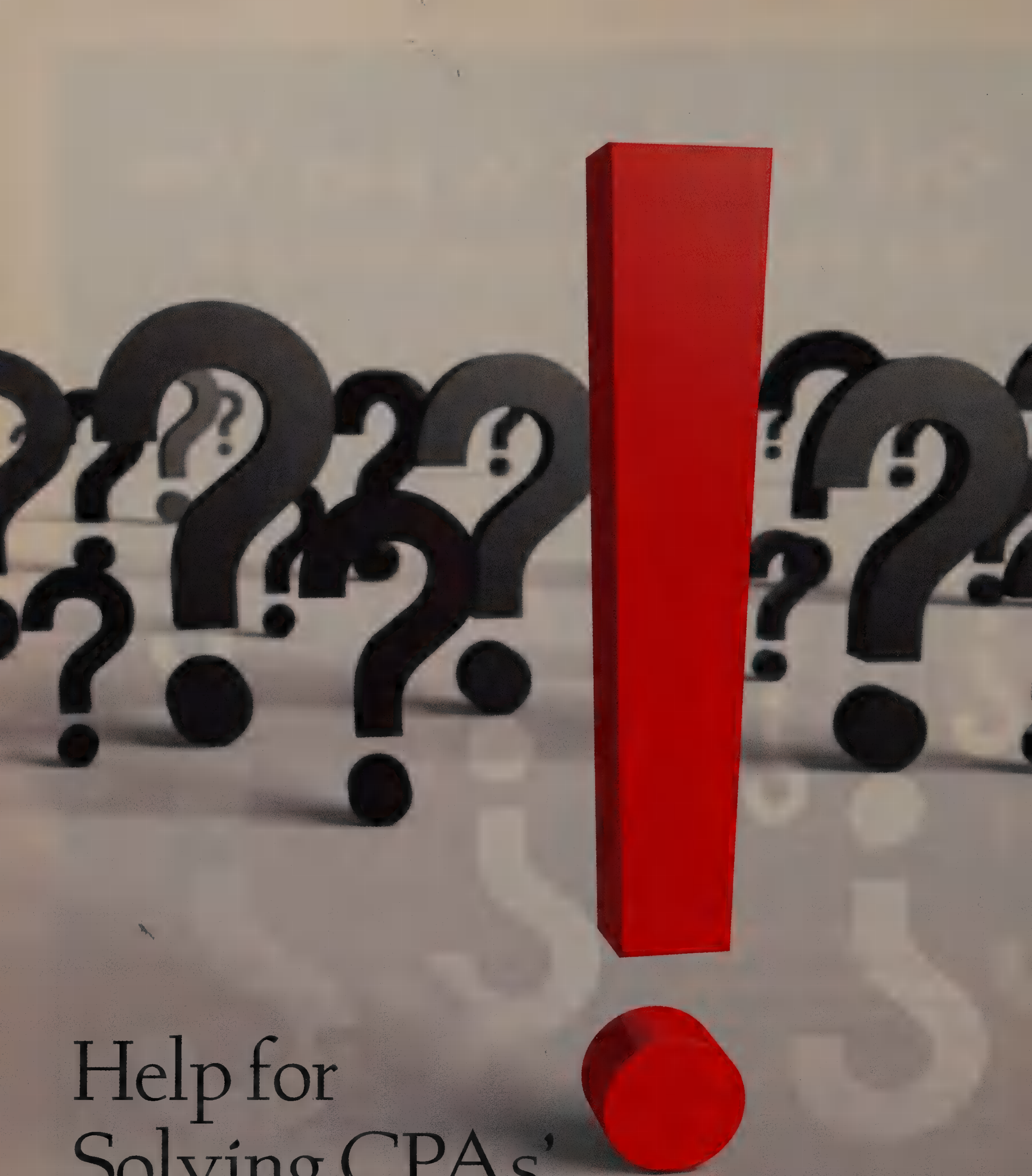
Washington, DC 20036
4000 Ponce de Leon Blvd., Suite 700
Miami, Florida 33146
Nationwide Toll Free Number:
1-800-275-3332



Help for Solving CPAs' Ethical Dilemmas

by Martin A. Leibowitz and Alan Reinstein

Company controller Plony, CPA, prepared his employer's 2007 financial statements knowing that they misstated revenues. The company's CEO, who could fire Plony at will, "strongly urged" Plony to record sales at full invoice prices despite customers' rights to return merchandise long after a normal return period. Plony's brother-in-law, a company in-house lawyer, wrote the sales contracts and assured Plony that recording the full sales amounts was appropriate. After investigating the misstatement, the Illinois Department of Financial and Professional Regulation revoked Plony's CPA certificate for "negligence in the preparation of financial statements" and "subordination of judgment" even though he was not in public practice.

In another ethics violation case, the California Board of Accountancy disciplined Hy Falutin & Co., CPAs, (the firm's name and other facts have been modified) when it audited a bank's financial statements while the firm's consulting group concurrently sold the client's debt consolidation services. The Board of Accountancy imposed a three-year CPA license probation plus frequent and costly peer reviews.

While the first example is a fictitious case intended to illustrate threats in the workplace, the second example is based on an actual situation that resulted in disciplinary action by the SEC and California Board of Accountancy. Attention to the AICPA's *Guide for Complying with Rules 102–505* could have helped these CPAs solve their ethical dilemmas and avoid violations of the AICPA *Code of Professional Conduct*. Using these two general examples, this article explains the guide's "threats and safeguards" approach to achieving compliance with the AICPA *Code of Professional Conduct* and applies that approach to the above ethical dilemmas.

Definitions

Acceptable level. A level where a reasonable and informed third party would likely conclude, weighing all specific facts and circumstances, that compliance with the rules is not compromised.

Threat. The risk that relationships or circumstances could compromise a member's compliance with the rules.

Safeguards. Actions or other measures to eliminate threats or reduce them to acceptable levels.

Overview

The AICPA's bylaws require *all* members (those providing services as employees, owners, volunteers or consultants; those in public practice, business, academia or government) to comply with the ethical requirements of the AICPA's *Code of Professional Conduct*. The code's *Rules of Conduct* govern members' performance of professional services, and its interpretations and rulings provide authoritative guidance to apply those rules to specific situations.

Since the code's rules, interpretations and rulings cannot address every possible ethically challenging relationship or circumstance, the AICPA issued on Nov. 10 *A Guide for Complying with Rules 102–505* to help

Rules of Conduct Covered by the Guide

The AICPA *Code of Professional Conduct* includes 11 rules (AICPA, *Professional Standards*, vol. 2, ET sections 100 to 500):

1. Rule 101, *Independence*
2. Rule 102, *Integrity and Objectivity*
3. Rule 201, *General Standards*
4. Rule 202, *Compliance With Standards*
5. Rule 203, *Accounting Principles*
6. Rule 301, *Confidential Client Information*
7. Rule 302, *Contingent Fees*
8. Rule 501, *Acts Discreditable*
9. Rule 502, *Advertising and Other Forms of Solicitation*
10. Rule 503, *Commissions and Referral Fees*
11. Rule 505, *Form of Organization and Name*

EXECUTIVE SUMMARY

The AICPA recently issued a guide to help CPAs comply with rules 102–505 of its *Code of Professional Conduct*, affecting members in public practice, business, academia and government.

The guide, while not an authoritative standard, provides an approach to help solve CPAs' ethical dilemmas. The approach involves identifying and evaluating ethical "threats" and, if a threat is more than trivial, applying "safeguards" to eliminate or mitigate the threat.

A "threat" is the risk that relationships or circumstances could compromise a member's compliance with rules of the AIPCA *Code of Professional Conduct.*

"Safeguards" are actions or other measures that eliminate threats or reduce them to acceptable levels.

Facing nontrivial threats and lacking effective safeguards, members should usually decline or discontinue the services creating the threats or consider resigning from the client or employing organization.

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CPAs solve ethical dilemmas not explicitly addressed in the code. The guide's use is not mandatory, and while it helps CPAs comply with the code in unusual ethical relationships or circumstances, the guide can never justify noncompliance with the code.

The guide's approach to ethical dilemmas applies to all rules except Rule 101, *Independence*, for which the *Conceptual Framework for AICPA Independence Standards* (2006, AICPA, *Professional Standards*, vol. 2, ET sec. 100.01) provides authoritative guidance.

Threats and Safeguards Approach

The guide's "threats and safeguards" approach can help members comply with the rules in situations not explicitly addressed in the code—an approach that the AICPA's Professional Ethics Executive Committee also uses when developing the code's interpretations and rulings.

The threats and safeguards approach identifies threats to compliance with the rules and evaluates the significance of those threats. If a threat is not at an "acceptable level" (see box, "Definitions"), members should determine whether safeguards can eliminate or reduce the threat to an acceptable level and, if so, apply such safeguards or, if not, avoid the situation that creates the threat. Members should evaluate in-the-aggregate a situation with multiple threats since the cumulative effect could be at an unacceptable level.

Identifying threats. Members often face risks of encountering relationships or circumstances that could compromise compliance with the rules (in other words, "threats") in their duties or work environments.

The guide provides six threat categories to help members identify and develop sensitivity to potential threats:

- **Self-review threat.** The threat that a member will not appropriately evaluate the results of prior services performed by the member himself or herself, or by an individual in the member's firm or employing organization.
- **Advocacy threat.** The threat that a member will promote a client or employer's position to the point that his or her objectivity is compromised.
- **Adverse interest threat.** The threat that a member will not be objective because his or her interests are in opposition to those of a client or employer.
- **Familiarity threat.** The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
- **Undue influence threat.** The threat that a member will subordinate his or her judgment to that of an individual associated with a client, employer or other relevant third party because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
- **Self-interest threat.** The threat that a member will act in a manner that is adverse to the interests of his or her firm, employer, client or the public, as a result of the member or his or her close family member's financial interest in or other relationship with a client or the employer.

Evaluating the significance of a threat. The existence of a threat does not necessarily mean noncompliance with the rules; rather, members should evaluate a threat's significance by considering whether a reasonable and informed third party, weighing all quantitative and qualitative facts and circumstances, would likely conclude that the threat would compromise the member's compliance with the rules. If this evaluation finds that the threat would not compromise a member's compliance, the threat is at an acceptable level, requiring no further evaluation under the guide. If the evaluation finds the threat at an unacceptable level, the member should identify and apply appropriate safeguards.

Identifying and applying safeguards. Required or prohibited actions and internal control measures can serve as safeguards to eliminate or reduce threats to acceptable levels. The profession, legislation and public regulations create some safeguards for all members. Employers implement other safeguards in the specific work environment. Members in public practice also may consider their client's safeguards when evaluating the significance of a threat.

Below are examples of safeguards and associated threats they might reduce:

- Peer reviews (actions required by the profession) that consider appropriate reliance on external evidence in attest engagements reduce undue influence threats.
- Periodic rotations of senior members on an attest engagement (actions required by Sarbanes-Oxley legislation

Examples of Threats to Compliance With AICPA Rules of Conduct

Situation	Threat
As part of an attest engagement, a member uses consulting work previously done by his firm.	*Self-review* and *self-interest threats* to compliance with rules 102 and 201.
A member has charged his employer with violating certain labor laws.	*Adverse interest threat* to compliance with Rule 102.
An employer pressures a member to be associated with misleading information.	*Undue influence threat* to compliance with rules 102 and 201
A member is directed to complete a task within an unrealistic time frame.	*Undue influence threat* to compliance with rules 102 and 201.
Revenue received from a single client is significant to the firm.	*Self-interest threat* to compliance with Rule 102.

or a firm's internal controls) reduce familiarity threats.

- Limitations of services to clients whose billings would be significant to the firm (actions prohibited by a firm's internal controls) reduce undue influence and self-interest threats.
- Avoiding joint ventures with a client (actions prohibited in a firm's internal controls) reduces advocacy and self-interest threats.
- Corporate governances that restrict certain services by the corporation's external auditors (actions prohibited by the client's internal controls) reduce self-review threats.
- Corporate policies that stress ethical behavior and provide channels to discuss ethical issues without fear of retribution (workplace internal controls, "tone at the top") reduce undue influence threats.

Determining which safeguard to apply requires judgment, since a safeguard's effectiveness can vary from one environment to another. Members should analyze a particular situation's facts and circumstances, identify significant threats and then design safeguards, considering:

- The safeguard's objective.
- Parties who will be subject to the safeguard.
- How the safeguard will be applied (for example, uniformly, consistently, objectively).
- Who will apply the safeguard (for example, a third party, a supervisor, a computer).

A threat is reduced to an acceptable level if, after applying safeguards, a reasonable and informed third party would likely conclude that compliance with the rules is not compromised.

What if there are no effective safeguards? A threat may be so significant that no safeguard can eliminate or reduce it to an acceptable level. If so, providing the specific professional or employee service will likely cause noncompliance with the rules. While declining or discontinuing the service would prevent a rules violation, the member should also consider the stronger response of resigning from the client or employment position.

Seek Advice

Before pursuing a course of action to resolve ethical dilemmas, a member may want to consult with legal counsel, applicable professional bodies, and appropriate firm or employer personnel. The AICPA provides an ethics hotline to assist members in this and other ethics issues. Inquiries can be made by phone, 888-777-7077 (menu option 5, followed by menu option 2), or via e-mail at ethics@aicpa.org. Members may be well-advised to document the ethical conflict's substance, details of discussions and suggested decisions.

Ethical Conflicts Unrelated to Threats

Members may confront ethical conflicts due to internal or external work-environment pressures or conflicts within professional standards unrelated to threats described above. For example, a member may encounter a fraud and feel ethically bound to report it; but reporting the fraud could breach Rule 301's mandate to maintain client confidentiality. To resolve such ethical conflicts and comply with the rules, the guide recommends that members:

a. Recognize and consider all relevant facts and circumstances, including applicable rules, laws or regulations,
b. Consider the ethical issues involved,
c. Consider established internal procedures, and then
d. Formulate alternative courses of action.

After weighing the consequences of each course of action, the member should select the course that best enables compliance with the rules.

Before pursuing the selected course of action, the member may want to consult with legal counsel, applicable professional bodies (see sidebar, "Seek Advice") and appropriate firm or employer personnel. If the conflict remains unresolved after pursuing the selected course of action, the member should consider further consultation with those advisers to review the process and reach a different resolution. Members may be well-advised to document the ethical conflict's substance, details of discussions and suggested decisions.

What if there is no effective resolution? If, after exhausting all reasonable possibilities, the ethical conflict remains unresolved, members will probably not be in compliance with the rules if they remain associated with the matter creating the conflict. In this case, members should consider withdrawing from the engagement team or specific assignment, and perhaps consider the stronger response of resigning from the client or employment position.

Applying the Guide to Two Ethics Violation Cases

CPA Plony, whose boss urged him to record transactions contrary to GAAP and whose brother-in-law analyzed GAAP for him, should have referred to Interpretation 102-4 (ET section 102.05) that prescribes potentially confrontational actions when a member's interpretation of GAAP differs from those of his or her supervisors.

However, with the guide's "threats and safeguards" approach, the unwelcomed need to invoke Interpretation 102-4 might have been avoided, as in this scenario: Plony recognized the CEO's authority to fire him at-will as an "undue influence threat" and his brother-in-law's legal counsel as a "familiarity threat." Plony wrote a memo to his files discussing both threats and his belief that a reasonable and informed third party, weighing all the facts and circumstances, would likely conclude that the threats—separately and in the aggregate—compromise his compliance with rules 102, 201 and 202.

He considered actions or policies that might reduce the two threats to acceptable levels and wrote to the company's audit committee suggesting safeguards to protect his objectivity: (1) an officer's employment termination should require a due process hearing before an independent arbitrator, allowing the officer to respond to allegations;

and (2) staff preparing financial statements cannot be related to staff generating transactions or related documents. The audit committee adopted the due process personnel policy and assigned Plony's brother-in-law to other legal matters. Plony properly deferred revenue recognition on the dubious sales in accordance with the provisions of FASB Statement no. 48.

The guide also could have helped Hy Falutin & Co., as in this revised sequence of events: Two audit team members familiar with the AICPA's threats and safeguards approach knew that the firm's consulting group was negotiating a client-firm joint marketing venture and wrote memos identifying a "self-review threat," "advocacy threat," "self-interest threat" and independence issues. Their memo labeled the threats "severe and urgent." The lead partner found that no safeguards could adequately reduce the threats to acceptable levels, and the firm immediately withdrew from the nonaudit activities.

Conclusion

All AICPA members must comply with rules 102–505 of the AICPA's *Code of Professional Conduct*. The recently issued AICPA *Guide for Complying with Rules 102–505* provides a prudent, though not required, "threats and safeguards" approach to help members solve ethical dilemmas in situations not explicitly addressed in the code's rules, interpretations or rulings. The guide defines six categories of threats to complying with the rules and analyzes strategies for identifying and applying safeguards to eliminate or reduce threats to acceptable levels. The guide also discusses "ethical conflict resolution" for situations where members encounter obstacles to following appropriate courses of action.

When no safeguard can reduce a significant threat to an acceptable level or when an ethical conflict remains unresolved, members will probably not comply with the rules, requiring them to consider declining or discontinuing the service, withdrawing from the engagement team or specific assignment, or even resigning from the client or employment position. ❖

AICPA RESOURCES

Publication

Guide for Complying with Rules 102–505, **http://tinyurl.com/34hxm4**

CPE

- *Real World Business Ethics: How Would You React?*, a CPE self-study course (#731685)
- *Selected Topics in Professional Ethics*, a CPE self-study course (#158384)

For more information or to place an order, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

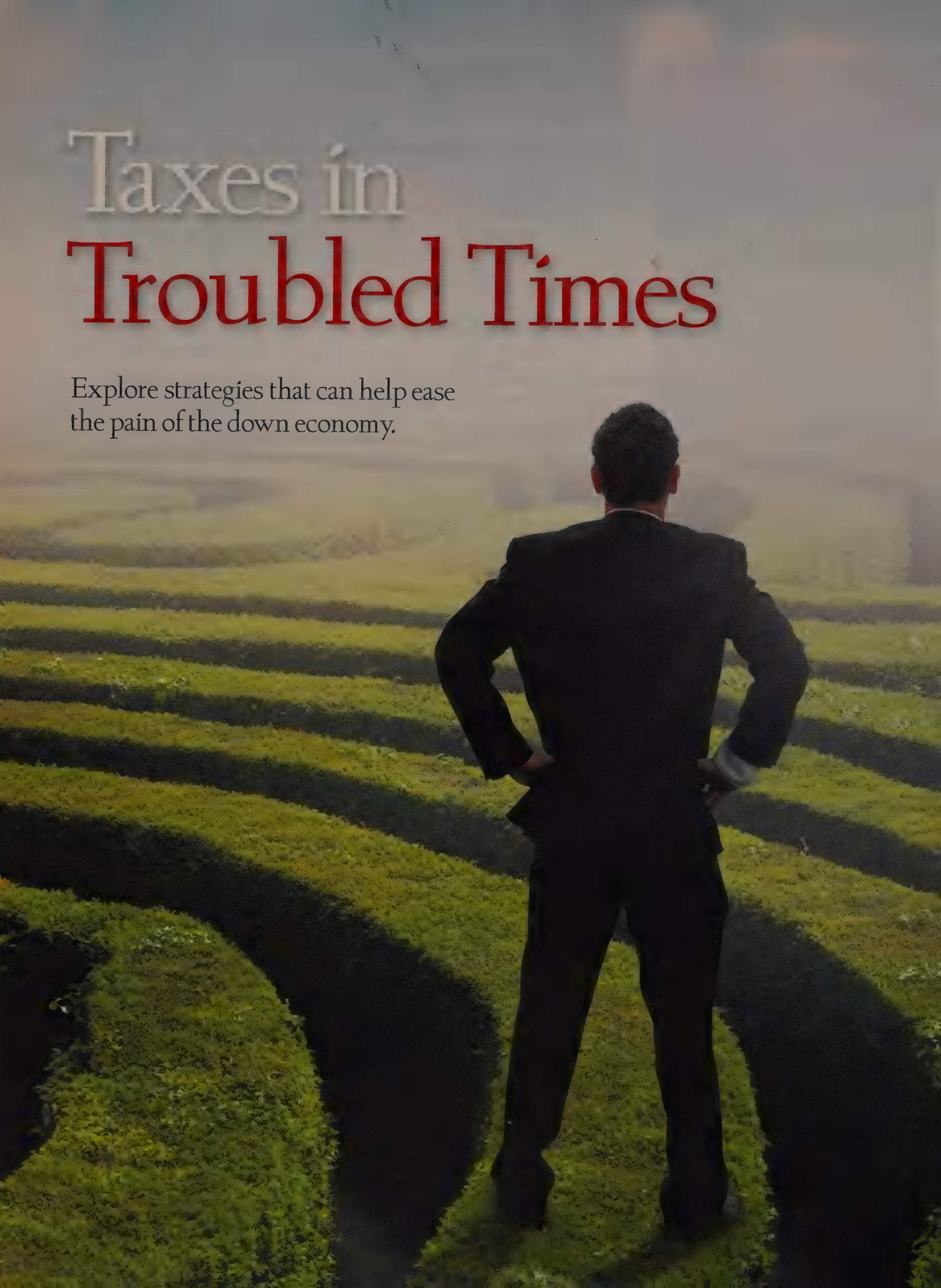
OTHER RESOURCES

Publication

Ethics for CPAs: Meeting Expectations in Challenging Times, by Dan M. Guy, D.R. Carmichael and Linda A. Lach; John Wiley & Sons, 2003.

Taxes in Troubled Times

Explore strategies that can help ease the pain of the down economy.



The IRS has acknowledged there's plenty of pain to go around in the current economic downturn. Financially strapped taxpayers can take advantage of several relief initiatives and provisions that could lessen their tax bite. Those with investments posting a loss may be able to "harvest" it or at least reposition themselves for favorable treatment of gains once the economy turns around. The *JofA* asked Tom Ochsenschlager, AICPA vice president–taxation, to describe some recessionary tax strategies for clients of CPA tax advisers and traps to avoid when financial market bears rule the day.

JofA: Owners of qualified tuition programs, better known as section 529 plans, can recognize an ordinary loss from them. How does that work?

Ochsenschlager: I think it's particularly interesting that the IRS has published [in Publication 970, *Tax Benefits for Education*] that if you have a 529 plan and the assets' fair market value is less than when you put them into the plan, then if you completely liquidate the plan, you can take that loss as an ordinary loss, not a capital loss. It is an opportunity for many people to go in, take the loss and then reinvest the proceeds in a new 529 plan.

If you do reinvest the proceeds, you do need to wait at least 60 days to avoid the transaction being characterized as a qualified rollover, which is tax-free but might not be considered a total distribution.

There's another big caveat, as well: It is an ordinary loss, but it's a miscellaneous itemized deduction subject to the 2% of AGI [adjusted gross income] limitation. And even worse, if taxpayers claiming the loss are subject to the AMT [alternative minimum tax], they won't get the loss at all. So you want to be pretty careful with that. But again, many people might have a relatively low AGI this year compared to other years because of the market's decline. Therefore, this might be an opportune time to take advantage of this provision. Even if the amount gets a 2% of AGI haircut, it still might be a lot better for the taxpayer than claiming a capital loss. [In Announcement 2008-17 (REG-127127-05), March 3, 2008, the IRS stated it plans to provide formal guidance on how to recognize a loss in a section 529 plan but that in the interim, taxpayers may rely upon the interpretation of Publication 970.]

JofA: Another tax-deferred account strategy that has been getting some attention is converting a traditional IRA to a Roth account. But aren't there some changes coming up in 2010 that could make it worth waiting until then to do a conversion? How can taxpayers decide whether to act now or wait?

Ochsenschlager: If you think the market is going to recover between now and Jan. 1, 2010, then you might want to consider doing it now. But keep in mind another big difference between 2010 and what we see today is that today there is a $100,000 modified adjusted gross income limit, not including the amount of the conversion. If you exceed that limit, or if you're married filing separately, you can't do a conversion.

In 2010 that income limit is eliminated, and married but separate filers may also take advantage of the provision. Furthermore, if you're doing the conversion in 2010, you get to pay the tax over two years, 2011 and 2012. So you get a full year's deferral, plus another year's deferral of half the amount. What's not to like there?

If the market is still down in 2010, I certainly hope it will recover sometime not too long after that. If and when it does, all that additional appreciation attributable to the recovery is not going to be taxed at all in the Roth as it would, of course, upon distribution from a regular IRA.

Another big advantage of a Roth is that if you think you might not need it, you don't have to make any withdrawals at age 70½. That's an advantage especially for high-net-worth individuals, because they really don't want to take distributions but would like to pass it on to their children or grandchildren. The Roth is a perfect vehicle to do that, because the children and grandchildren won't be taxed, either.

Then again, if you think that appreciation will start occurring sooner rather than later, you're within the income limit and you can forgo the tax deferral, you might consider a Roth conversion this year. You could hedge your bets. It's not an all-or-nothing thing. If your income is lower than normal—as it might be for many people right now—or your itemized deductions are high and you can convert just enough to avoid getting up into a higher marginal

rate, you might do that. A good crystal ball helps.

***JofA:* But otherwise, individual taxpayers generally are limited to $3,000 in net capital losses that they can deduct against ordinary income, right?**

Ochsenschlager: That's right. The good news, if there is any good news, is that the $3,000 is carried over for the rest of your life; there's no limit on the number of years it can be carried over. But if you have $60,000 in losses and then you don't have a prospect of any long-term capital gains in the future, you're talking 20 years.

***JofA:* You hear the warnings about the possibility of taxable capital gain distributions from mutual funds even when their net asset value has gone down by a far greater amount.**

Ochsenschlager: That catches people off guard all the time. The market has gone south, and mutual fund investors know the funds didn't do well. They get the report, and they're saying, "Well, at least I don't have any tax effects." They should be very careful, because it's not unlikely they'll have large capital gains. This happens when many investors are hitting the panic button and fund managers need cash to redeem people out. There's a tendency for them to sell the stocks that they think have peaked out, in many cases stronger stocks. That sometimes generates a capital gain that you'd never expect.

***JofA:* Another surprise to some is cancellation-of-debt (COD) income. Home mortgage debt has been talked about and given relief by Congress, but what about credit cards, where taxpayers may think their settlement isn't going to be taxable?**

Ochsenschlager: And it is. I think if you went to the bus stop and asked people if someone negotiated their debt down and the lender forgave the debt, would they be taxed on it, they'd say, "No, because I didn't get anything. It's just something I don't have to pay." They got the cash and then they spent it on something apparently, because they didn't have the cash to pay it back. And so they benefited from it directly or indirectly, and they owe tax on it. That catches a lot of people off guard, and of course there are not many in that position who can pay the tax. It is excluded from income, however, when it occurs within bankruptcy proceedings or to the extent that the taxpayer is insolvent. It can also be excluded if it secures a qualified principal residence and a few other instances found in Internal Revenue Code section 108.

If none of those exclusions applies, you could attempt an offer in compromise (OIC) with the Internal Revenue Service. One of the big disadvantages of an offer in compromise, however, is that you have to pay 20% of the tax you owe upfront before they look at the papers, and it's not refundable.

> "I think the Service realizes they'll have to be a little more open to (working with taxpayers) because you can't get blood out of a turnip."—Tom Ochsenschlager

***JofA:* For those reasons, OICs have fallen off pretty drastically, haven't they? Yet the Service recently highlighted them in a news release, along with reminders of other measures by which it said it can provide assistance to distressed taxpayers. Can taxpayers really expect more enforcement relief?**

Ochsenschlager: Given the economic conditions, we believe the IRS is going to work with taxpayers more than they have in the past. I think the Service realizes they'll have to be a little more open to it, because you can't get blood out of a turnip.

***JofA:* In the American Reinvestment and Recovery Act of 2009, Congress allowed small businesses, those with gross receipts of $15 million or less, to carry back a 2008 net operating loss five years rather than two. It's been suggested this kind of relief might not have as much stimulus effect as accelerated depreciation and higher dollar limits on section 179 expensing. What's your take on that?**

Ochsenschlager: It's debatable. Obviously, a company that can use the five-year carryback is a company with current losses. Accelerated depreciation methods, on the other hand, could help companies that are currently profitable by stimulating their interest in acquiring additional assets in the current year. So it's a bit of an economic judgment as to where you see the most important part of the stimulus: Stimulate profitable companies and encourage them to acquire assets in the near future, or help companies that are having a difficult time currently in the economy by permitting them to get a refund of taxes they paid in prior years.

My own personal view is that a five-year carryback will provide a stimulus. Keep in mind that if the company has had losses for the whole five years, it can't get a refund, because it won't have any taxes to recover. If, on the other hand, it was profitable three, four or five years ago but maybe not profitable in the past two years, that may be the profile of a company that has fallen on hard times just on a temporary basis. And therefore, by recovering some taxes they have paid in prior years, they may be able to pull themselves up by their bootstraps and become profitable going forward.

***JofA:* Another business provision of the stimulus act provides for deferral to 2014 and spreading over five years of COD income on reacquisition of debt occurring this year and next. Might it also be of some benefit?**

Ochsenschlager: A lot of companies don't have cash to buy back debt, but if they do, this could represent a substantial tax benefit. ❖

Stimulus Act Eases Taxes for Individuals, Small Businesses

by Alistair M. Nevius and Paul Bonner

With the enactment of the American Recovery and Reinvestment Act of 2009 on Feb. 17, Congress delivered a smorgasbord of tax relief items to individual taxpayers and small businesses. While the specifics of those measures were the subject of whirlwind conference negotiations in Congress, the outcome reflects an attempt to give targeted tax benefits to the broad middle class and less-affluent Americans. At the same time, it seeks to stoke the engine of economic recovery by allowing small businesses to accelerate depreciation and carry back operating losses and by encouraging them to hire veterans and youths.

Tax Breaks for Individuals

College students and their families, homebuyers, and buyers of new cars are among the act's potential beneficiaries, but so too are low-income Americans, with the act's continuation and expansion of such tax breaks as a higher eligibility limit for the earned income tax credit.

Higher education. The American opportunity tax credit is a temporary (for tax years beginning in 2009 and 2010) increase and expansion of the Hope scholarship credit (IRC § 25A(i)). It increases the maximum credit per student from $1,800 to $2,500 and extends its availability from the first two years of postsecondary education to four years. Nonrefundable under prior law, the credit now becomes 40% refundable.

The phaseout range is increased from the current $50,000 to $60,000 for single filers to $80,000 to $90,000. The joint filer phaseout, currently $100,000 to $120,000, increases to $160,000 to $180,000. Expenses for course materials, such as textbooks, are added to the definition of qualified tuition and related expenses eligible for the credit.

"It's going to involve a tremendous amount of planning for CPAs," particularly where families with college students might be liable for the recently expanded kiddie tax, said Art Auerbach, CPA, a tax director at Goodman & Co. LLP in Tysons Corner, Va., and a member of the AICPA's Individual Tax Resource Panel. "If you could get the college student perhaps on their own standing and claiming their own exemption, the fact that part of this credit is refundable is a real benefit."

Homebuyer's credit. The act increases the maximum amount of the IRC § 36 first-time homebuyer's credit from $7,500 to $8,000 and eliminates the repayment requirement for houses purchased in 2009. The credit, added by the Housing Assistance Tax Act of 2008, PL 110-289, is refundable, but for homes purchased between April 9, 2008, and Dec. 31, 2008, it must be recaptured ratably over 15 years, or earlier if the home is sold. The stimulus act waives the recapture requirement for homes purchased after Jan. 1, 2009, and extends the sunset of the credit from June 30, 2009, to Dec. 1, 2009.

The amount of the credit remains 10% of the purchase price of a principal residence of a taxpayer who has not owned a U.S. principal residence in the previous three years. Recapture still applies if the taxpayer disposes of the home or no longer uses it as a principal residence within three years after purchase. The waiver of recapture isn't retroactive to before 2009, Auerbach noted.

"I feel really badly for the people who ran out under the old provision and settled on a house before Dec. 31," Auerbach said. "So they got a $7,500 credit, but they have a payback that starts in 2010."

Making work pay credit. Intended to partially offset an employee's portion of Social Security payroll taxes, this temporary credit is 6.2% of earned income up to a total credit of $400 for individuals and $800 for joint filers (IRC § 36A). It is retroactive to the beginning of 2009 and is set to expire at the end of 2010. It begins phasing out at a rate of 2% of modified adjusted gross income (MAGI) above $75,000 for individuals and $150,000 for joint filers.

New car sales tax deduction. Buyers of new cars and light trucks between Feb. 17, 2009, and the end of the year may deduct the portion of state and local sales and excise taxes attributable to the first $49,500 of the vehicle's purchase price (IRC § 164(b)(6)). This is an above-the-line deduction and is allowed against alternative minimum tax (AMT). The deduction will be phased out for single taxpayers with MAGI in excess of $125,000 for the tax year ($250,000 for joint filers). Taxpayers who elect under section 164(b)(5) to take the state and local sales tax deduction in lieu of deducting state and local income tax cannot also take the new car sales tax deduction.

The individual benefit, not to mention economic stimulus, may be negligible if potential buyers of new cars can't get financing, Auerbach said. "That comes under, in my opinion, 'nice try,' " he said.

AMT patch. For 2009, the AMT exemption is increased to $46,700 for singles and $70,950 for joint filers (IRC § 55(d)).

Section 529 plans may buy computers. For 2009 and 2010, the costs of computers and related technology qualify as higher education expenses for purposes of the rules governing distributions from a section 529 qualified tuition plan, as long as the beneficiary of the plan is enrolled at an eligible educational institution. Internet access charges are also covered, as well as software, so long as it's not for sports, games or hobbies (unless the software is predominantly educational in nature).

Qualified transportation fringe benefit increase. Another reason to vanpool or take public transit to work arrived with a near doubling of the exclusion amount for a transportation fringe benefit from $120 to $230 per month (the same as the qualified parking amount) (IRC § 132(f)). This higher limit is effective March 2009 and through 2010 with an annual inflation adjustment.

Child tax credit and other items. The act extends for 2009 and 2010 the lower, $3,000 income threshold for refundability of the section 24 child credit, meaning more of it is refundable to low-income taxpayers. Other items directly benefiting less-affluent taxpayers or those in financial distress include a temporary increase in the earned income tax credit for 2009 and 2010, a one-time $250 payment to persons on fixed incomes not eligible for the making work pay credit and a temporary exclusion of $2,400 of unemployment benefits from taxable income for 2009.

Small Business Tax Breaks

Bonus depreciation. IRC § 168(k) is amended to extend the 50% first-year bonus depreciation through 2009 (through 2010 for certain transportation property and aircraft).

The election to accelerate AMT and research credits in lieu of taking the bonus depreciation (which had been introduced last year by the Housing Assistance Tax Act) is also extended to qualifying property placed in service through 2009. Special rules apply to taxpayers who had already made this election for property placed in service in 2008.

Section 179 expensing. The increase in the section 179 expensing amount to $250,000 and the increase in the phase-out threshold to $800,000 are both extended through 2009. The amounts had originally been temporarily increased (for 2008) by the Economic Stimulus Act of 2008, PL 110-185.

Carryback of small business NOLs. Eligible small businesses are allowed to carry their 2008 net operating losses (NOLs) back for five years (section 172(b)(1)(H)). An eligible small business is one that has average gross receipts of $15 million or less (using the gross receipts test from section 448(c)). The act gives the Treasury Department authority to publish antiabuse rules relating to this provision.

Small business estimated taxes. Qualified individuals are allowed (for 2009 only) to make estimated tax payments that equal only 90% of their preceding tax year liability instead of 100% (under section 6654(d)(1)). To be a qualified individual, the taxpayer must have adjusted gross income (AGI) of less than $500,000, and more than 50% of the individual's gross income must come from a small business (a business with an average of fewer than 500 employees).

Work opportunity tax credit. The act creates two new targeted groups for the work opportunity tax credit: "disconnected youth" and unemployed veterans (section 51(d)(14)). Employers who hire members of these groups during 2009 or 2010 may be eligible to take the credit.

Discharge of business indebtedness. The act allows certain businesses to recognize cancellation-of-indebtedness income over five years, starting in 2014, if the business repurchases specific types of debt in 2009 or 2010 (section 108(i)).

Qualified small business stock. The section 1202 exclusion of gain from the sale of qualified small business stock is increased from 50% to 75% for stock acquired after the enactment date and before Jan. 1, 2011.

S corporations. The recognition period for assets subject to the built-in gains tax is reduced from 10 years to seven years for S corporation tax years beginning in 2009 and 2010 (section 1374(d)(7)).

Limitations of loss carryforwards. For businesses that have ownership changes pursuant to a restructuring plan required

by a Treasury loan agreement or line of credit under the bailout provisions of the Emergency Economic Stabilization Act, PL 110-343, the section 382 limitation on loss carryforwards will not apply.

New markets tax credit. The section 45D new markets tax credit investments limit is increased for 2008 and 2009 to $5 million.

Notice 2008-83 restricted. The act expresses Congress' doubt about the legal authority of Notice 2008-83 (the "Wells Fargo Ruling") and states that it is inconsistent with congressional intent in enacting section 382(m). Therefore, the act restricts the notice's effect to changes in ownership occurring (or subject to a binding written contract entered into) on or before Jan. 16, 2009. (For more on the questions surrounding Notice 2008-83, see White, "Notice 2008-83: The Ripples Keep Spreading," *Tax Insider*, Feb. 2, 2009.)

Energy credits. The act also includes a number of energy incentives aimed at both individuals and businesses, including increases in the section 25C residential energy property credit, the section 25D residential energy efficiency property credit, and the energy investment credit under section 48. ❖

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AICPA RESOURCES

Conferences

- AICPA Conference on Tax Strategies for the High-Income Individual, May 7–8, Las Vegas
- AICPA Small Business Practitioners Tax Conference, July 12–14, Seattle

For more information or to register, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

Web site

Economic Crisis Resource Center, **http://economy.aicpa.org/**

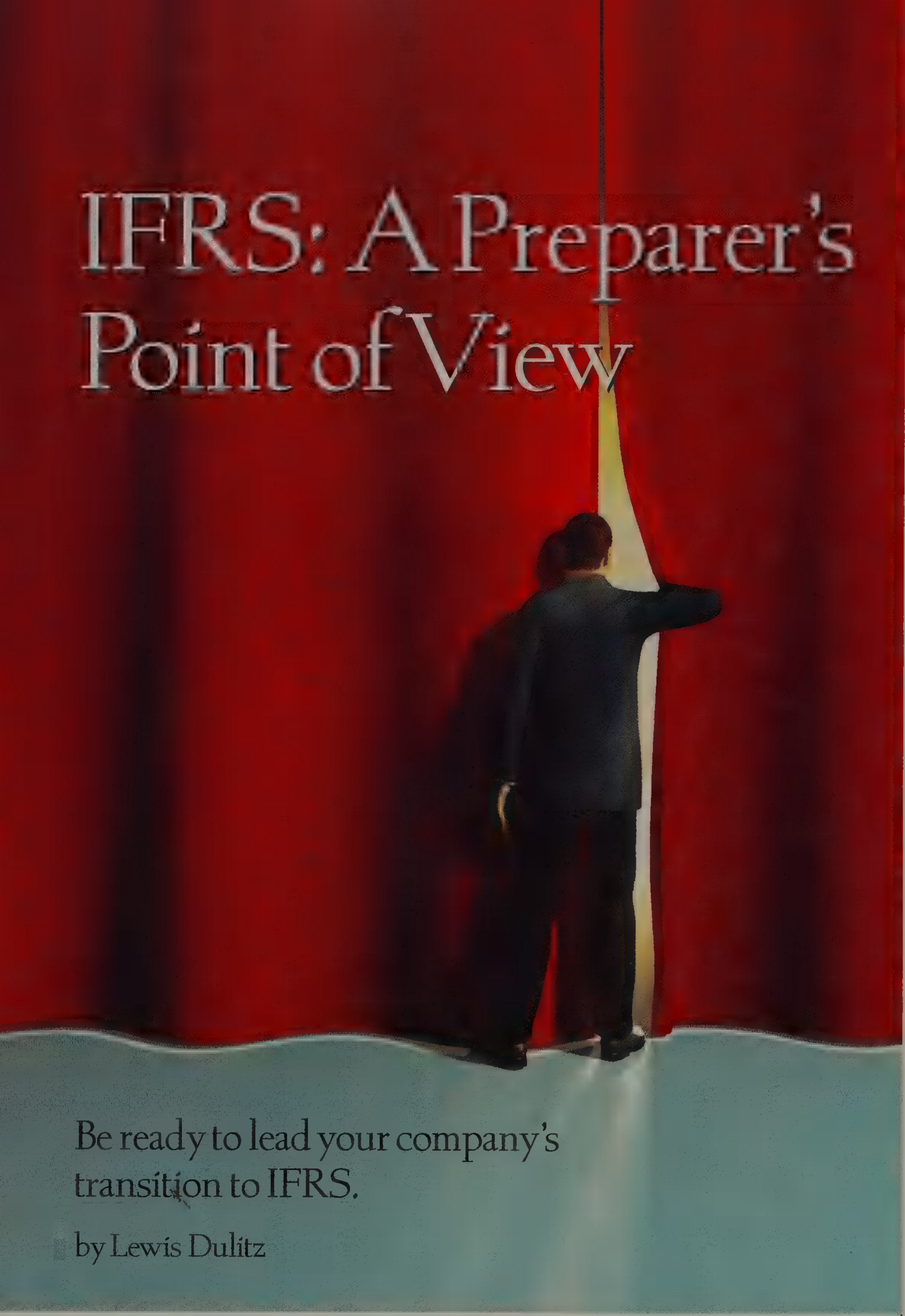
***The Tax Adviser* and Tax Section**

The Tax Adviser is available at a reduced subscription price to members of the Tax Section, which provides tools, technologies and peer interaction to CPAs with tax practices. More than 23,000 CPAs are Tax Section members. The Section keeps members up to date on tax legislative and regulatory developments. Visit the Tax Center at **www.aicpa.org/TAX**. The current issue of *The Tax Adviser* is available at **www.aicpa.org/pubs/taxadv**.

OTHER RESOURCES

American Recovery and Reinvestment Act of 2009

The full text of the act is available at **http://tinyurl.com/avu66p**



IFRS: A Preparer's Point of View

Be ready to lead your company's transition to IFRS.

by Lewis Dulitz

If you think IFRS is difficult for CPAs to comprehend, talk to non-CPAs. Historically, accounting professionals have insulated their colleagues from understanding the effort involved in implementing newly issued accounting standards. As a result, you cannot expect them to understand the challenge associated with adopting an entirely new framework.

To successfully implement IFRS, CPAs will need the assistance and insight of their colleagues. IFRS provides preparers many options to elect policies that best reflect the underlying business. Input from key stakeholders in the company is crucial for anticipating potential changes in company practices and ensuring the proper elections are made.

Presentations and proposals by audit firms and consultants feature robust IFRS implementation methodologies that typically start with an assessment phase called Phase 1. What many audit firms and consultants do not realize is how many companies are not ready for Phase 1.

Phase 0: Internal Education

Because IFRS knowledge is limited in the United States, each project should start with Phase 0: Internal Education. Unlike the situation experienced by European companies in 2004, today a wealth of free information is available on the Internet. Start with the AICPA's Web site, **www.ifrs.com**. In addition, each Big Four firm has published IFRS overviews and checklists highlighting the differences between IFRS and U.S. GAAP.

As a preparer it is important to understand your auditor's interpretation of IFRS. You should also read the other large firm IFRS publications to see where there is diversity of opinion before making policy elections. This review should provide a solid foundation enabling you to identify areas for your company that may require significant policy, process or system changes.

This analysis will be critical to your internal message. Publication of the SEC's proposed road map to IFRS adoption may have unintentionally created a false sense of security in your organization. For example, it may be difficult for the senior management team of a large, accelerated filer to understand why IFRS should be a priority today over another project when its first annual filing is not expected until the first quarter of 2015 under the SEC proposal. However, the SEC's proposal would require comparative financial statements for 2012, 2013 and 2014. (In February the SEC extended the comment period for its proposed road map. See "Highlights," page 12.)

In Phase 0, you should develop and conduct a training session for senior

Key Activities in Phase 0

- Education
- Identifying technical accounting differences
- Determining resource requirements

Exhibit 1 Technical Accounting Differences Summary

Accounting Topic	*Summary of Issue*	*Department(s) Impacted**
Revenue	IFRS does not contain specific guidance for multiple-element arrangements, therefore a difference may exist in terms of the identification of a single vs. a multiple-element arrangement as well as how revenue is allocated across those elements (fair value vs. cost plus a reasonable margin).	Sales, Legal
Business Combinations	Pre-FASB Statement no. 141(R), companies must capitalize in process research and development (IPR&D) and fair value contingent consideration.	M&A
Research & Development	Development expenses may be eligible for capitalization earlier under IFRS.	Manufacturing
Fixed Assets	Componentization of assets will require standardizing how composite assets are broken into components and may require system changes. Depreciation will also be accelerated due to shorter useful lives.	Fixed Assets, Financial Planning & Analysis, Information Systems (IS)
Leases	There are no bright-line tests for the determination of lease classification, capital vs. operating.	Capital Planning
Impairment	Impairments may be reversed under IFRS. A process must be developed to identify triggers for reversal.	Local Management
Restructuring	There is no minimum retention period under IFRS so charges may be recognized sooner.	Human Resources, Business Units
Contingencies	A liability is recognized when it is more likely than not (> 50%) instead of probable (> 80%).	Legal

*Only essential departments outside of accounting are listed. Others may be impacted depending on how your business is organized.

management on the basics of IFRS. This training should include a summary of the potential top differences you have identified from a technical accounting perspective (see Exhibit 1). Make the presentation interactive so you can get their input as to how they believe adoption affects their departments.

Phase I: Assessment and Strategy

The first important consideration the implementation team will face is whether to adopt or to convert. These terms are often used interchangeably to describe a company's movement to IFRS, though each approach implies taking a separate path. Adoption suggests that the preparer will view IFRS as a new starting point and evaluate all accounting options before selecting a company policy. Conversion suggests that the preparer will limit the focus to only identified differences between IFRS and U.S. GAAP.

In 2005, many European companies chose the conversion approach. This approach was popular for companies that started the implementation process late or wanted to minimize the number of reconciling items included in their footnote disclosure. In 2007, the SEC removed the requirement for foreign private issuers to include the footnote reconciliation to U.S. GAAP.

Moving to a new framework means preparers should challenge themselves

EXECUTIVE SUMMARY

■ **Start your IFRS implementation project with *internal education* rather than *assessment*.** Consider the IFRS publications provided by the AICPA and all of the Big Four firms, not just those provided by your external auditors. Develop and conduct a training session for senior management on the basics of IFRS that includes a summary of the potential top technical accounting differences.

■ **Develop a strategy.** First decide whether to *adopt* or to *convert*. *Adoption* views IFRS as a new starting point and evaluates all accounting options before selecting a company policy. *Conversion* limits the focus to only identified differences between IFRS and U.S. GAAP.

■ **Assess impact on business.** The second important consideration is the extent to which IFRS will affect the business. IFRS provides companies the opportunity to restructure not only their accounting, but the underlying transactions as well.

■ **Be prepared to be audited in a "GAAP triangle."** In your initial year of adoption, you may be audited under as many as three GAAPs: U.S. GAAP, IFRS and statutory GAAP (for tax purposes). This extra dimension to the audit can be time-consuming and complicated.

■ **Create a steering committee and core project team.** The steering committee should be comprised of senior management from accounting, tax, communications, human resources, investor relations, legal, information systems, manufacturing and sales. The dedicated core team will identify technical accounting differences, draft the corporate accounting manual, interact with external auditors, work with information systems to design the system reporting requirements and conduct global training programs.

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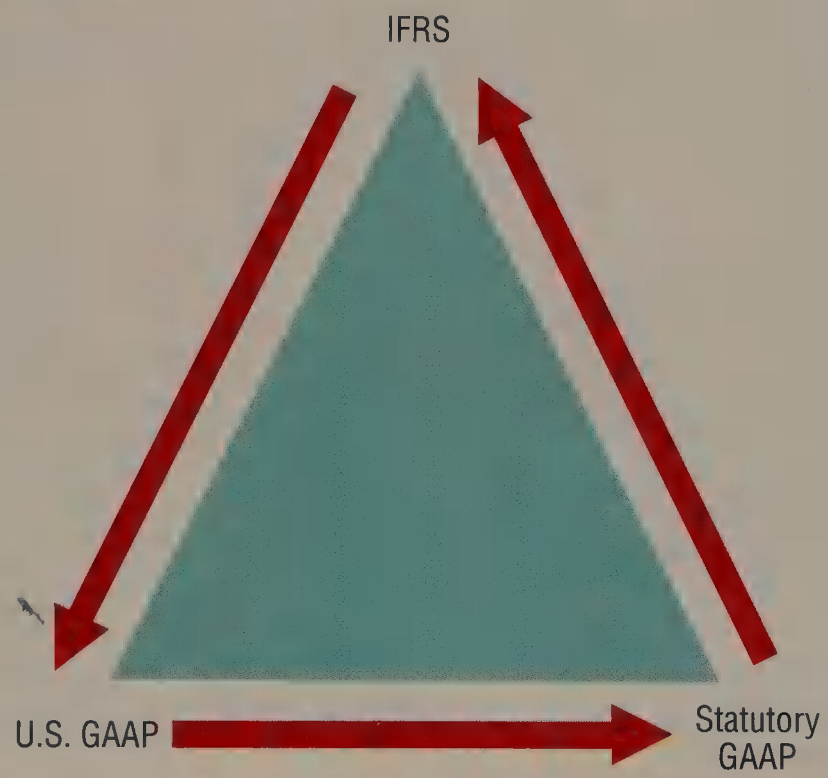
Exhibit 2 Internal and External Factors to Consider

INTERNAL FACTORS	*EXTERNAL FACTORS*
Support of senior management	SEC final regulation
Availability of qualified resources	Comment letters
Complexity of business	Progress on MOU milestones
Complexity of legal/accounting structure	Analyst and investor interest in IFRS information
Sophistication of internal systems	Competitors' speed of adoption
Demand for IFRS information	Internal Revenue Service

Exhibit 3 GAAP Triangle



not to view issues only through a U.S. GAAP point of view. The preparer should understand the substance of the transaction to leverage the principles-based framework of IFRS and then select the accounting conclusion that is most representative. Like U.S. GAAP, once a company has established its accounting policies under IFRS, it must demonstrate preferability when changing an accounting policy in future years.

If you are trying to decide which approach is best for your company, consider that FASB refers to its approach as "improve and adopt." Without adoption, the goal of a single set of accounting standards will never be achieved. The "improve" initiative can be seen in FASB's updated memorandum of understanding (MOU) with the International Accounting Standards Board that prioritizes certain joint projects for completion in 2011.

The second important consideration is the extent to which IFRS adoption will affect the business. The European IFRS implementation was widely criticized as being merely a top-side implementation. In this "change the scorecard" type of implementation, no underlying business practices are changed. The accountants simply recalculate the financial statement results using IFRS principles. To truly embrace the opportunity, companies should review business process, contracts and transaction structure. Involved upfront, CPAs can partner with operations management to assess the impact on transactions of accounting options available under IFRS.

When developing your company's implementation approach, the internal and external factors shown in Exhibit 2 will influence the project's depth and scope.

Impact on the Audit

In your initial year of adoption, you may be audited under three or more GAAPs. These "GAAP triangles" occur when neither IFRS nor U.S. GAAP can be used as the basis of accounting to meet statutory filing requirements (see Exhibit 3).

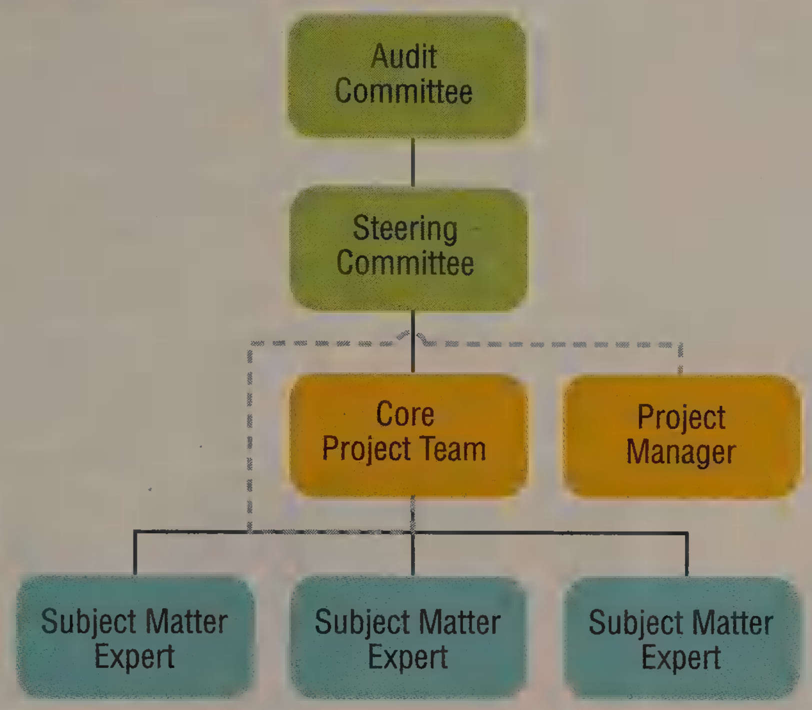
For example, if an entity with statutory reporting obligations in the Netherlands had disclosed a difference in its reconciliation between Dutch GAAP and U.S. GAAP and there were no changes in policy between Dutch GAAP and IFRS, the expectation would be that the entity would report a difference between IFRS and U.S. GAAP. The preparer must explain the impact of adoption not only on the company's former primary reporting GAAP but also on its statutory GAAP. This adds an extra dimension to the audit that can be time-consuming and complicated. Unlike the infamous Bermuda Triangle where material objects disappeared, material objects may appear thanks to the "GAAP triangle."

Parallel reporting will likely be a reality for most companies beginning in 2012. This raises several questions:

- How many GAAPs will you track?
- At what level will you track the GAAPs (consolidation system, local ERP or both)?
- How long will you run in parallel?

This initiative will require working

Exhibit 4 Governance Structure



closely with your information systems team to build the architecture and reporting to complete the consolidation of financial statements under the desired number of GAAPs. In 2005, best practice was to track two GAAPs, but the bar has now been raised to track three. Because statutory GAAP is often used as a basis for tax reporting, you will need to work closely with your tax department to determine the ramifications of any changes to the basis of statutory reporting. Deloitte's IAS Plus Web site (**www.iasplus.com/country/useias.htm**) lists jurisdictions where IFRS is acceptable for statutory reporting purposes. The specificity of U.S. GAAP guidance allowed audit firms to create detailed audit programs. With IFRS, there will be a fundamental shift. Auditors will need to evaluate the reasonableness of their client's interpretation of IFRS guidance, as well as the consistency of application within the client.

Although auditors cannot be involved in policy election, they can provide valuable insight regarding available accounting options, industry and firm perspectives, as well as SEC interpretations based on previous staff reviews. IFRS has fewer rules than U.S. GAAP, so more judgment will be back in the hands of preparers and auditors. Judgment allows the preparer the flexibility to improve the transparency of the financial statements but comes with the risk of inconsistency of application. To mitigate this risk, companies should create a robust corporate accounting manual that drives consistency across business units and geographies. Audits should be based on compliance with the manual to reduce local auditor interpretations.

Project Governance

IFRS adoption is a multiyear project that requires not only strong governance, but leaders who will sustain momentum over the life of the project. Creation of a steering committee under the oversight of the audit committee can help sustain this momentum and can provide high-level organizational support for the project (see Exhibit 4). The steering committee should comprise senior management representatives from accounting, tax, communications, human resources, investor relations, legal, information systems, manufacturing and sales.

For the day-to-day implementation activities, you need a core project team, headed by a talented project manager. This team must be 100% dedicated to the project. The core team will be responsible for identifying technical accounting differences, drafting the corporate accounting manual, interacting with the auditors, working with information systems to design the system reporting requirements and conducting global training programs. The core team should be supplemented with subject matter experts, who are allocated to assist with specific topic areas. These experts, who are not working full time on the project, will be responsible for validating the accounting differences, identifying process/system changes and quantifying differences. External auditors should be involved throughout the implementation process.

IFRS is the future of accounting in the United States and whether you are a member of the core project team or a subject expert, you should begin work on Phase 0 today. ❖

AICPA RESOURCES

JofA articles

- "IFRS: Beyond the Standards," Feb. 09, page 34
- "Interest Capitalization: One Small Step Toward Convergence," May 08, page 80
- "Simplifying Global Accounting," July 07, page 36
- "IFRS: Coming to America," June 07, page 70
- "Found in Translation," Feb. 07, page 38

CPE

International Versus U.S. Accounting: What in the World is the Difference?, a CPE self-study course (#731665)

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Convergence Update

IFRS Converges to U.S. GAAP on Segment Reporting

by Barry Jay Epstein and Eva K. Jermakowicz

As part of the convergence effort between IFRS and U.S. GAAP, the International Accounting Standards Board published IFRS 8, *Operating Segments*, which became effective Jan 1. IFRS 8 supersedes IAS 14, *Reporting Financial Information by Segment*, and closely resembles the "through the eyes of management" approach of FASB Statement no. 131, *Disclosures about Segments of an Enterprise and Related Information*.

IFRS 8 applies to the individual financial statements of an entity and the consolidated financial statements of a group with a parent (a) whose debt or equity instruments are traded in a public market or (b) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market. *Reportable* segments are operating segments, or aggregations of operating segments, that meet or exceed one of several quantitative thresholds; smaller segments may be optionally disclosed.

Under IAS 14, dual segment classifications were required—by both business and geographic area—with the primary typology determined by the predominant driver of the reporting entity's risks and returns. Under IFRS 8, operating segments may be defined by product, geography or other attributes—consistent with management's decision-making processes.

IFRS 8 allows for the discrete reporting of a component of an entity that sells primarily or exclusively to other operating segments of the entity so long as the entity is actually being managed consistent with that strategy. This means that vertically integrated operations may be composed of several segments for the purpose of IFRS 8.

The principal mode of disclosure is governed by the concept of *operating segments* (a) that engage in business activities from which they may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance, and (c) for which discrete financial information is available.

This so-called "management approach" is so strictly interpreted under IFRS 8 that the amounts of each reportable operating segment item must be the same measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance. This requirement means that segment disclosures based on internal measures can diverge from IFRS.

The former product and geographical area disclosures have not been entirely forsaken. IFRS 8 requires the reporting entity to provide information about the revenues derived from its products or services, which can be grouped by similarity, about the countries in which it earns revenues and holds assets, and about major customers. The standard also requires disclosure of factors used to identify the entity's operating segments, including the basis of organization and types of products and services from which each reportable segment derives its revenues.

IFRS 8 requires an entity to report a measure of segment profit or loss and of segment assets. It is also required to report a measure of liabilities for each reportable segment if such an amount is regularly provided to the chief operating decision maker. It also requires disclosure, for each reportable segment (if the amounts are included in the determination of segment assets, or otherwise are reviewed by the chief operating decision maker), of the amount of investment in associates and joint ventures accounted for by the equity method, and the total expenditures for additions to noncurrent assets other than financial instruments, deferred tax assets, postemployment benefit assets and rights arising under insurance contracts.

IFRS 8 requires an explanation of any differences between amounts reported for segment purposes and those for the entity as a whole; the nature and effect of any changes from prior periods in the measurements used; and the nature and effect of any asymmetrical allocations (where bases vary) to reportable segments.

Finally, a series of reconciliations are potentially necessary for the total of the reportable segments' revenues, total profit or loss, total assets, total liabilities and other amounts disclosed, to corresponding amounts in the entity's financial statements. All material reconciling items must be separately identified and described. ❖

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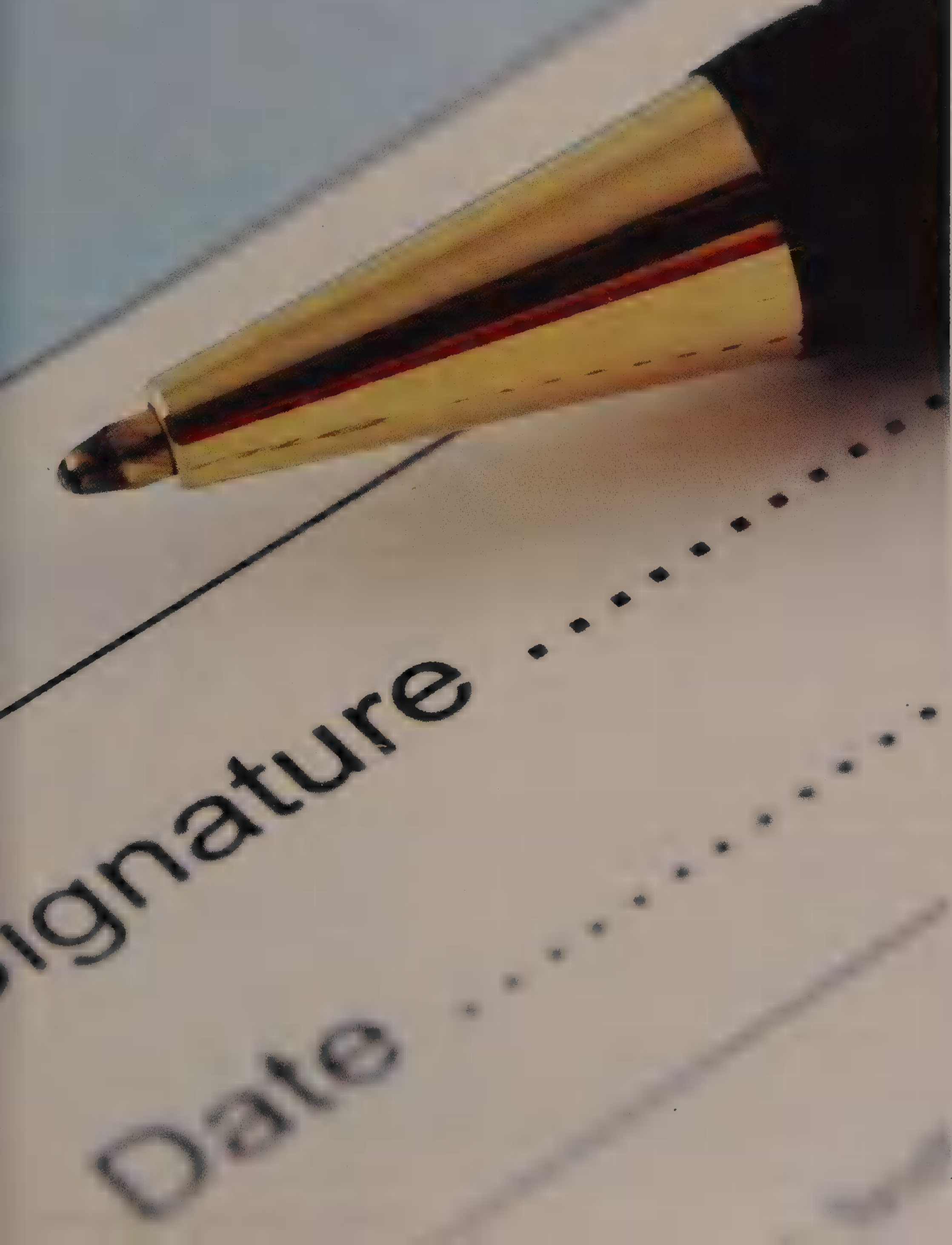
Tax Considerations for Buying and Selling Property With a Burdensome Lease

by Larry Maples, Mark Turner and Beth Howard



An economic downturn like the current one can cause fixed lease obligations to become burdensome and trigger a significant negative impact on leasing in many markets. Real property and other business assets may have been leased in a sale-leaseback transaction, or the lessee may have simply desired use but not ownership of the asset. Some lease contracts may provide favorable terms to the lessee in the early years, but the terms purposely turn unattractive in later years to ensure that lessees eventually purchase the property.

When a lease becomes burdensome (the obligation exceeds the benefits), a taxpayer may try to terminate it. If the lessee pays a cancellation fee, tax law generally allows a deduction, because no future benefit is created. As an alternative to cancellation, the lessee could buy the property from the lessor. Recent litigation demonstrates that the lessee's tax treatment of such a purchase is unsettled, though the tax results of lease terminations from the landlord's perspective are more predictable.

Lessee Payments

The IRS may allow a lessee to deduct lease cancellation payments if they are not integrated in some way with the acquisition of another property right. In Letter Ruling 9607016 issued in 1996, the IRS said a lease termination payment could not be deducted in the year paid where it was part of an overall plan to acquire and relocate to another site. The IRS held that the lessee's right to terminate was conditioned on acquiring a new site and starting construction. The IRS noted that in a prior case and ruling, termination payments had been deductible when they were paid to eliminate expenses or relieve a taxpayer from an uneconomic contract and those situations were not integrated with the

acquisition of another property right.

When a lessee terminates a lease by buying the leased property, the acquisition of a property right is obviously integrated with the lease termination. Not surprisingly, the IRS will also require capitalization in this situation. Its rationale is that IRC § 167(c)(2) prohibits an allocation of a portion of the cost to the leasehold interest. The Tax Court agrees, but a district court recently allowed a lessee to deduct the portion of the purchase price allocable to a burdensome lease. In what circumstances may a lessee reasonably take the position that the amount paid for property in excess of its value is a deductible lease termination payment?

The Tax Court in *Union Carbide Foreign Sales Corp.* (115 TC 423 (2000)) considered a situation in which the lessee of a ship had the option to pay $135 million to terminate a burdensome lease or buy the ship for nearly $108 million. The ship's fair market value without the lease was less than $14 million. The taxpayer exercised the purchase option and deducted nearly $94 million ($108 million – $14 million) as a lease termination expense. The Tax Court did not allow the deduction, with the result that the taxpayer had to recover the entire $108 million over the remaining life of the ship.

The IRS did not contest the taxpayer's claim that the lease was burdensome. Instead, it argued that the statutory language in section 167(c)(2) prohibits a deduction for the part of the purchase price attributable to the onerous lease. That provision does not allow any of the basis to be allocated to the leasehold if "property is acquired subject to a lease." The statute does not define "subject to a lease," but the IRS and Tax Court interpret the phrase to mean subject to a lease prior to acquisition. The taxpayer unsuccessfully argued that the statute refers only to ongoing leases and that because its acquisition of the ship ended the lease, the taxpayer was entitled to the deduction.

However, there is precedent for a deduction in the Sixth Circuit. In *Cleveland Allerton Hotel* (36 AFTR 862 (6th Cir. 1948)), a tenant paying excessive rent of about $15,000 per year and with 80 years remaining on the lease negotiated an acquisition of the property for an amount that exceeded the fair market value by $241,250. The Sixth Circuit overturned the Tax Court and allowed a deduction while chiding the IRS for elevating form over substance in requiring a taxpayer to capitalize an asset at more than double its fair market value.

In cases cited in this article, the amount paid to terminate the lease and purchase the property far exceeded the property's fair market value. However, there is no bright line to identify when a lease becomes burdensome or onerous.

ABC Beverage

The U.S. District Court for the Western District of Michigan recently followed *Cleveland Allerton* and allowed a business deduction for the portion of the purchase price attributable to a tenant's excessive lease (*ABC Beverage Corp. v. U.S.*, 102 AFTR2d 2008-5905, 8/27/08; see also "Tax Matters: Lease Buyout Portion of Purchase Ruled Deductible," *JofA*, Dec. 08, page 94). A subsidiary of *ABC* acquired a lease with a rent escalator clause and purchase option. The $6.25 million difference between a negotiated minimum price of $9 million and the property's market value was allowed as a business deduction by the district court.

The IRS again argued that a deduction was not allowable because section 167(c)(2) prohibits an allocation of part of the purchase price to the leasehold interest. But the court, whose decisions are appealable to the Sixth Circuit, said the phrase "subject to a lease" in section 167(c)(2) applies to a third-party purchaser who steps into a reversion in the continuing lease but not to a lessee whose purchase ends the lease.

The district court also went to some lengths to counter the IRS' contention that the *Cleveland Allerton* precedent had been nullified by the Supreme Court in *Millinery Center Building Corp.* (350 U.S. 456, 49 AFTR 171 (1956)). In that case, the Supreme Court affirmed the Second Circuit, denying a taxpayer deduction. In *ABC*, the IRS contended that *Millinery Center* established the principle that the cost of buying out a burdensome lease via a property purchase is not deductible. But the district court in *ABC* said the deduction in *Millinery Center* was not disallowed because of section 167(c)(2) but because the taxpayer failed to prove the lease was burdensome. Thus, the court in *ABC* said, the split between the circuits was not resolved, and the *Cleveland Allerton* precedent

EXECUTIVE SUMMARY

- **When a lessee terminates a lease by purchasing the leased property,** the IRS requires capitalization of the entire purchase price. However, some courts have allowed the excess of the price over the fair market value to be deducted as the cost of buying out a burdensome lease.
- **Under IRC § 1234A, lessors receiving payment** from a lessee purchasing the leased property realize a capital gain or loss on the entire transaction if the property qualifies as a capital asset.
- **However, this treatment would not apply** when the lessor sells a lease contract to a third party. In that case, the seller would recognize ordinary income from the sale's proceeds.
- **A third party that acquires property subject to a lease** must record the entire adjusted basis for tax purposes and recover it by depreciation. Lease payments received would be ordinary income.

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allowing a deduction still stands. Other circuits besides the Sixth and the Second have been silent on the issue.

The *ABC* court granted summary judgment to the taxpayer but then vacated the order to allow trial on the issue of when economic performance occurred. On Dec. 22, 2008, at the end of a three-day trial, a jury found all issues in favor of the taxpayer, including that the property was "delivered or accepted, as evidenced by beneficial ownership in 1997," the year the deduction was claimed. The government had argued that economic performance did not occur until 1999.

Lessor-Sellers

Lessors that receive payment from the sale of real property realize capital gains or losses if the property sold qualifies as a capital asset. IRC § 1234A treats any payment received by the lessor to terminate or cancel any lease associated with the property as a sale or exchange of a capital asset. Therefore, when a lessee, as in *ABC Beverage,* chooses to exercise its option to acquire leased property, the entire transaction results in a capital gain or loss to the lessor.

The legislative history suggests that section 1234A was changed in response to inconsistent treatment by the courts of the disposition of rights and obligations associated with capital assets. In particular, there were many instances where transactions were not regarded as sales or exchanges, and therefore no capital gain or loss could result. Section 1234A states that "gain or loss attributable to the cancellation, lapse, expiration, or other termination of a right or obligation … with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer … shall be treated as gain or loss from the sale of a capital asset."

The word "property" was substituted in 1997 for "personal property" to correct what Congress viewed as inequitable treatment for similar and related transactions. This change overrode the Supreme Court's decision in *Hort v. Commissioner* (313 U.S. 28, 25 AFTR 1207 (1941)) that treated lease termination payments received by lessors as ordinary income. In addition, because both the property sale and the lease termination receive sale or exchange treatment, there is no need for the seller to argue that these events are the same capital transaction, as was the case prior to 1997 (see *Gurvey v. U.S.*, 57 AFTR2d 86-1062).

It should be noted that section 1234A does not apply to the sale of a right or obligation. For example, if a lessor sold a lease contract to a third party, the proceeds must produce ordinary income to the lessor. To treat it otherwise would allow a seller to easily convert ordinary lease income into a capital gain simply by selling the contract.

When owners hold rental property as trade or business assets, gains or losses

Practice Tips

In a period of declining real estate values, CPAs of both lessees and lessors should be alert to the tax planning implications of property acquisition opportunities.

Structuring a property acquisition as two contracts, one for the value of the lease and one for the property, could bypass the Tax Court objection to allowing a deduction in the year of acquisition. However, the IRS could counter with the step-transaction doctrine.

CPAs with Sixth Circuit clients (Michigan, Ohio, Kentucky and Tennessee) can find some court precedent supporting the taking of a deduction for the portion of a lessee's purchase price attributable to a burdensome lease. However, because of the *Millinery Center* case, Second Circuit taxpayers (New York, Connecticut and Vermont) may be in a weaker position to take such a deduction. CPAs may want to evaluate the authorities and make a judgment whether to claim substantial authority for a deduction position or to capitalize the costs.

from the sale of the real property are section 1231 gains or losses. Payments received from the termination of lease contracts would then fall outside the scope of section 1234A, producing section 1231 gains or losses, as the associated property is not a capital asset as defined in section 1221. Net section 1231 gains, of course, receive capital gain treatment, while net section 1231 losses are ordinary (see "Best of Both Worlds?" *JofA*, March 09, page 64). Whether owners hold real property as trade or business assets versus capital assets is determined by whether substantial services beyond basic property management tasks are performed on behalf of tenants.

Third-Party Buyers

Should a third party step into the shoes of the lease-holding landlord, payments for the property and accompanying lease contract do not receive separate treatment. As noted earlier, section 167(c)(2) provides that if any property is acquired subject to a lease, no portion of the adjusted basis shall be allocated to the leasehold interest. The entire adjusted basis is used for computing depreciation on the property subject to the lease. Treatment under IRC § 197, *Amortization of Goodwill and Certain Other Intangibles*, is precluded by section 167(c)(2). Thus, the property's adjusted basis is recovered via depreciation. Lease payments received would be ordinary income. If the lease contract alone was acquired by a third party in a transaction not including the property itself, section 197(e)(5)(a) disqualifies the lease interest from amortization under section 197.

Looking Ahead

Since the tax treatment for lessees who buy property with a burdensome lease is unsettled, CPAs should closely monitor any IRS guidance. Also, future litigation outside the Second and Sixth circuits could be illuminating. ❖

AICPA RESOURCES

***JofA* articles**

- "Best of Both Worlds?" March 09, page 64
- "Tax Matters: *ABC* Not So Simple," Jan. 09, page 70
- "Tax Matters: Lease Buyout Portion of Purchase Ruled Deductible," Dec. 08, page 94
- "Tax Matters: Lease Termination Costs," April 01, page 72

***The Tax Adviser* and Tax Section**

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Simplify and Improve Your Office System

Put your workstations on a diet, and let your server do the heavy lifting.

by Jeff Lenning

Talk about pressure—and not just in tax season. Keeping office computer systems up and running in small and medium CPA firms is an enormous and unending responsibility. Without reliable computing and communication capabilities, your staff, your clients and your business are dead in the water.

To mitigate the risk of downtime for individual employee workstations, consider a configuration that simplifies hardware and software maintenance and administration, and improves disaster recovery. This article introduces such a setup, which also can lower costs, boost security and even shrink your organization's carbon footprint.

Almost all firms use PCs as their standard workstations, with each computer's hard drive containing most if not all software its owner uses. In that configuration, users often store on networked file servers all the data they share with their co-workers.

But there's another network configuration worth considering—one that employs *application servers*, which provide access to the software, such as Microsoft Office and key tax and accounting programs, your entire staff uses.

This setup is neither new nor appropriate for every business environment, but it may work for your firm. Here's why: While traditional networked file servers hold all shared *data*, application servers store all shared *programs*. So, for example, instead of every PC having a copy of QuickBooks, the software resides only on the application server, where each user can access it from his or her workstation.

For CPA firms that can't afford downtime on even one workstation, application servers work well for two reasons. First, all software maintenance is easier because it's done on only one machine—the server. Second, because the server performs all storage and computing, workstations are uncomplicated, inexpensive devices you can replace in minutes after a failure, quickly restoring employees to productivity. Moreover, simpler, smaller workstations consume less energy and take up less landfill space when discarded, endearing them to cost- and eco-conscious managers. Result: Application servers are a good fit for more organizations than ever before.

Below, we'll discuss the new and improved benefits—and potential limitations—of this approach. Before you make any decisions, though, speak with your IT staff about how well an application server could satisfy your firm's needs. See

the sidebar "Consult With IT" for issues to discuss.

Note that this article covers two kinds of tasks. Some are complex evaluations you should make only with your IT staff's support. But others are less complicated aspects of setting up an application server and its workstations, which can be normal desktop PCs or *diskless thin clients*—desktop machines with no hard drive. Laptops, too, can serve as workstations, and if their data is stored on the server, the risk of data theft is eliminated. The following passages clearly indicate when you should proceed only with IT's assistance.

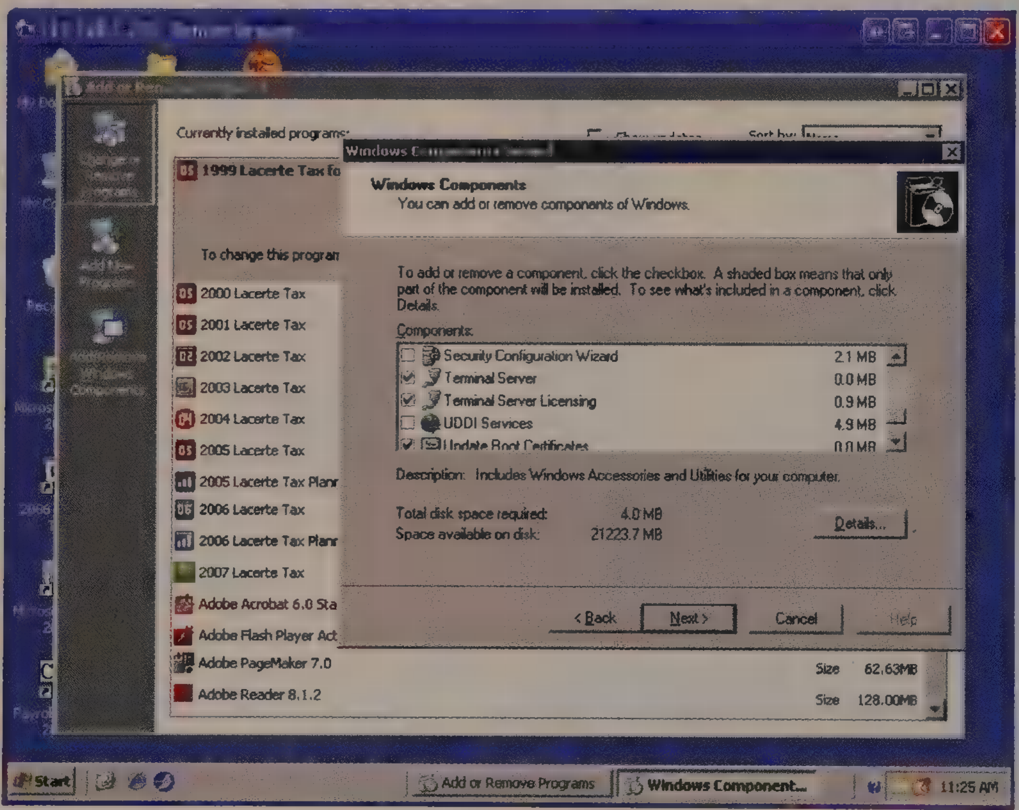
Lots to Like

Consolidating your firm's software programs on an application server provides several benefits.

Centralized control. Installing and managing your software will be simpler and quicker. Because QuickBooks, Lacerte and similar applications reside only on the application server, you don't need to install or update them on individual workstations. Installing the application only on the server enables all employees to instantly use the same version of all shared programs. Note that this differs from a typical client/server application, in which part of the program is stored on the server and another is installed on the workstations. In an application server configuration, you

Exhibit 1 Windows Terminal Server Installation

Ensure that Windows Terminal Server is installed. To do this, click on **Start > Control Panel > Add or Remove Programs > Windows Components**.



Connecting From Other Devices

Even non-Windows devices can connect to a Windows application server. Mac users can download and install *Remote Desktop Connection Client* at **www.apple.com/downloads/macosx/networking_security/remotedesktopconnectionclient.html**. It enables a Mac to run Windows-based applications on a Windows Terminal Server. If you are working in a Linux environment, install *tsclient* or *rdesktop*, which often are included in the Linux operating system. If you want to connect from a Blackberry, buy, download and install *Mobile Admin 4.1* from **www.rovemobile.com/mobileadmin/features/**. If your PDA uses Windows Mobile, a Remote Desktop client is included.

EXECUTIVE SUMMARY

The sudden failure of even one or two employees' PCs can seriously compromise a small or medium CPA firm's ability to timely meet its clients' needs.

Inexpensive, energy-efficient PC replacements—known as *diskless thin clients*—fail less often than PCs, and, when they do, can be loaded with all necessary software in minutes.

To minimize workstation downtime, some firms are installing *application servers*, which contain all software the entire firm uses. This configuration enables deployment of economical, low-maintenance employee workstations.

An application server is neither a new nor universally appropriate IT solution, but it may be the best option for many organizations that can't afford any significant interruption in an employee's productivity. Firms should carefully weigh the costs and benefits of this approach before adopting it.

Converting to an application server environment involves technological challenges of varying levels of complexity. While CPAs can resolve many of these issues independently, they should consult with their IT advisers on those this article identifies as esoteric.

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install the program on the server, but not on the workstations.

Remember that you must comply with each application's end user licensing agreement. Don't assume that all these documents have the same provisions. Some applications are licensed per installation, others per concurrent user, and still others per end user—concurrent or not. So read them carefully, and buy as many licenses as needed to cover your staff's use of the software.

Exhibit 2 Connecting to Remote Desktop

Enter the server computer name or IP address and click on **Connect**.

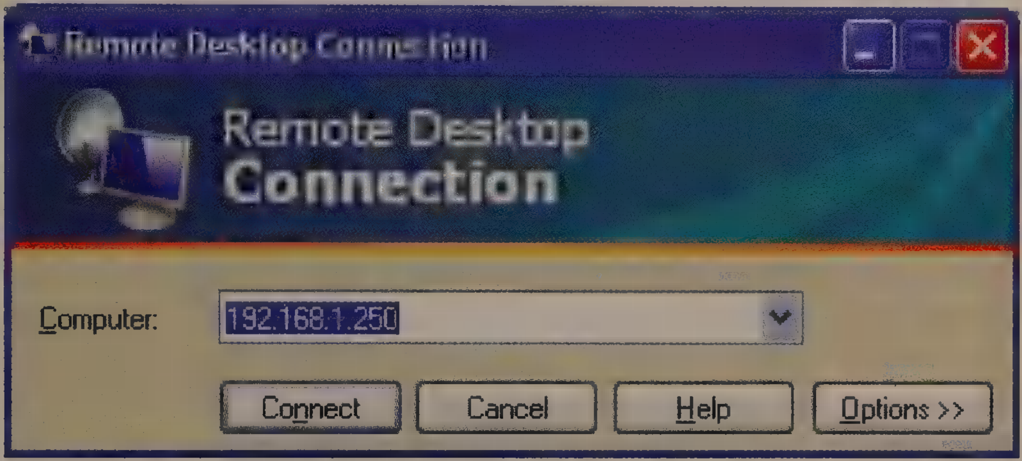
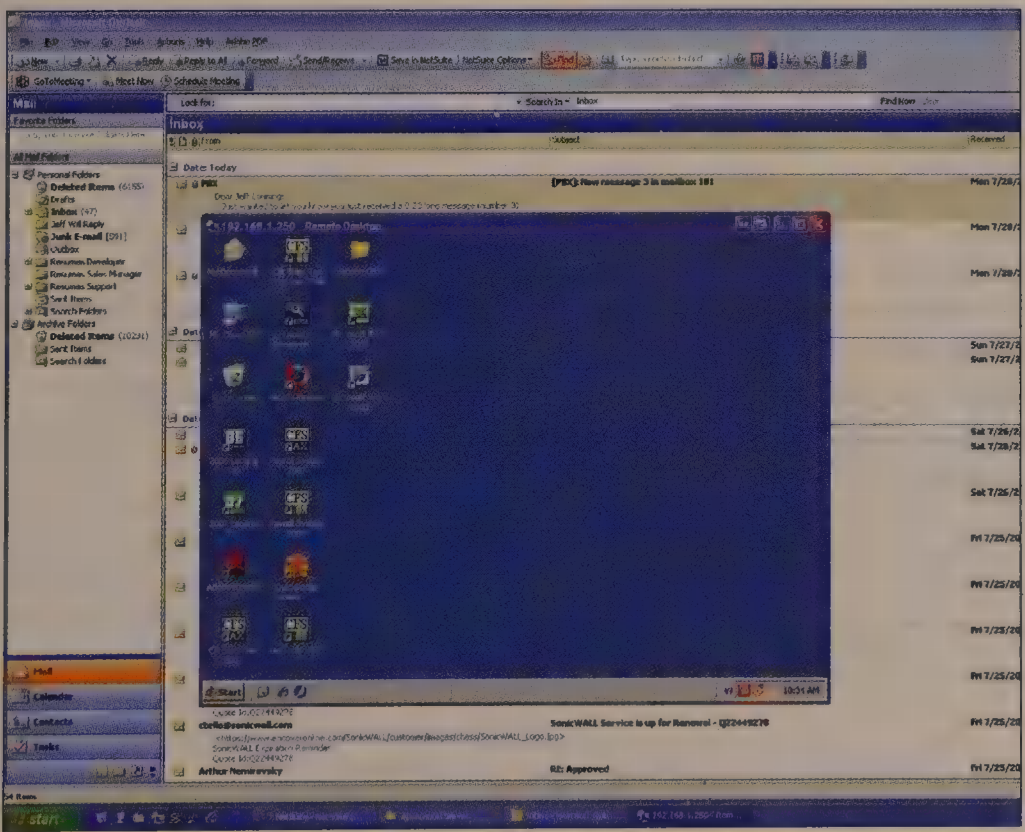


Exhibit 3 Remote Desktop View

A typical Remote Desktop connection window, which you can expand to full-screen mode if desired.



Faster desktop configuration and disaster recovery. Because the firm's key software and all prior years' tax programs are on the application server, you can set up a new workstation in minutes. You'll also save precious hours by no longer having to reinstall software on replacement PCs.

Less expensive workstations. No longer is it necessary to spend $1,500 on a fast, powerful system for each employee. Instead, to meet all your employees' computing needs, you could opt to deploy $300 thin clients.

More environmentally friendly. The newest thin clients use less than half as much electricity as today's PCs. So, replacing a desktop PC with a thin client can cut greenhouse gas emissions in half. Moreover, thin clients (with fewer moving

Implementation Tips

Start with a pilot program. There's no need to move every employee to the application server configuration at once. Instead, try it with a few employees and one or two applications. Test it, make adjustments as necessary, and roll it out gradually.

Get good hardware. Don't skimp. Get name brand, high-quality server hardware. For general hardware specifications and guidelines, see the sidebar "Consult With IT."

Maximize Internet access speed. If you have remote workers, their workstations' performance will correspond to the speed of your firm's Internet connection. High-speed cable, DSL and T1 connections all perform well. But if staff outside the office experience delays when communicating with the server, consider increasing your upload speed, which many ISPs will do for free or for a small charge.

parts and, therefore, fewer potential points of failure) outlast PCs by an average of three to four years. That helps reduce the quantity of discarded electrical equipment, which is rising nearly three times faster than that of other types of refuse.

Greater mobility. With an application server in place, an employee can use virtually any kind of workstation. An employee can connect to the server from the same office, a client location, home, an airport or coffee shop. Whether he or she uses a laptop, desktop PC, diskless thin client, a Mac or a Linux machine, he or she has access to everything available in the office.

Stronger laptop security. In a traditional configuration, laptops contain programs and confidential client data that can be compromised if the laptop is lost or stolen. But when configured to use an application server, laptops have no data to steal.

Less chance of hardware failure. With no moving parts, diskless thin clients are immune to hard-drive crashes.

Keep your dual monitors. Workstations connected to two screens can continue to use them after converting to an application server configuration. You also can span a remote desktop connection across both monitors by using the */span* option in Remote Desktop version 6.0, which is included in Windows Server 2008.

System software likely included. Because Microsoft manufactures Terminal Server (TS) and Remote Desktop, the software required for this setup, they probably are already installed on your firm's computers as part of the operating system.

Consult With IT

- *Application compatibility.* Through research and testing, your IT staff will be able to determine whether each of the applications you need runs on a Terminal Server and whether its developer supports it in a TS environment. For example, Intuit technical support will provide assistance only on TS installations for the Enterprise version of QuickBooks. Generally, most applications function well on a TS.
- *Check peripheral compatibility.* Not all hardware devices are supported in a TS environment. For example, an application running on the TS might not be able to send output to a printer attached to your desktop PC. Have your IT staff check that functionality, as well as your scanner's ability to work with software running on the TS. If it doesn't work, install the application on the workstation instead of on the server. Be aware that might not be possible with diskless thin clients, which generally cannot connect to scanners, printers and other peripherals.
- *Licensing.* Microsoft has changed its Terminal Server licensing requirements over the past several versions. Talk with your IT staff to ensure that you are in compliance. For example, if you are connecting to a Windows 2000 TS from a workstation running Windows 2000 or XP, no extra licenses are required. Windows Server 2003 includes two free concurrent (that is, simultaneous) connections; if you need more, additional licensing is required. Also, be sure to install and configure the licenses properly. Improperly licensed TS will run properly during the trial period but stop working when the trial period expires. The retail list price for five additional TS licenses is $749.
- *Windows 2008 vs. Windows 2003.* Microsoft made several enhancements to Terminal Server with the 2008 version, including *RemoteApp*, which enables you to launch individual applications remotely by double-clicking an icon on the client computer, rather than by delivering an entire desktop. Also included is *TS Web Access*, which provides a Web-based interface and improved printer support without installing drivers on the TS.
- *Hardware guidelines.* The type of hardware you should buy depends on the number of your concurrent users, the types of applications they will use, the connection speed required, and your budget. With an application server, as well as any other server in your office, a redundant array of independent disks (RAID) is strongly recommended. This technology ensures that, even if a disk drive fails, the server will continue running and will allow adequate time to locate and install a replacement drive. Your memory needs will depend on the number of your concurrent users; plan on a minimum of 2GB.
- For further discussion on hardware requirements, please refer to **www.microsoft.com/windowsserver2003/techinfo/overview/tsscaling.mspx**.

Bear in Mind

Along with many benefits, installing an application server may impose new system requirements or limitations. Consider the following carefully:

Greater reliance on the server. If you use an application server, your employees will depend greatly on its availability. But if they currently retrieve data from a file server, your firm is already exposed to potential server downtime and likely manages this contingency.

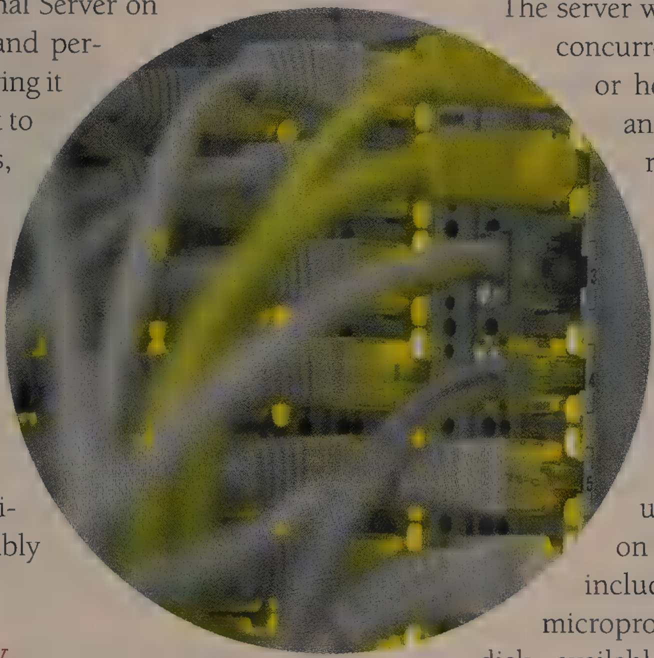
Application support questionable. Some developers do not support installations of their software on a Terminal Server. In fact, not every application will run in a Terminal Server environment. So have your IT staff check with developers before you buy an application server to host critical software.

Peripheral support uncertain. Terminal Server may not support all your

scanners, printers and other peripheral devices. Find out from their manufacturers before you proceed.

Complicated licensing. Microsoft offers Terminal Server in what can be a bewildering variety of configurations and licensing arrangements. You'll have to take extra care to understand them and choose the ones that best meet your firm's needs.

Greater dependence on others. Installing a Terminal Server on your network, and perhaps also deploying it over the Internet to remote workers, increases your firm's reliance on IT staff. So if you want your own accounting staff to manage and maintain your network, Terminal Server probably is unsuitable.



HERE'S HOW

If you already own a server and have few employees, none of whom requires remote access, you may be able to continue using only your existing server. But if you'll be giving access to more than a few employees or connecting them from remote locations, your IT staff probably will recommend buying a dedicated application server. Because this is a complex strategic decision, see "Consult With IT" for hardware specifications and guidelines.

After speaking with your IT staff, you can set up the application server by following these steps:

1. Log on to your Microsoft Windows server, and make sure Terminal Server is installed and running (see Exhibit 1).

2. Install on the server the applications your employees need.

3. To connect to the server, each employee should open the Remote Desktop Client on his or her workstation, enter the server name or IP (Internet Protocol) address (see Exhibit 2), and click on **Connect**. To make it easier for your employees to do this, you could install a shortcut on their desktop so they can simply double-click it and complete this task.

You then will see a Windows desktop in your Remote Desktop window (see Exhibit 3). You can double-click on icons, use the **Start** menu, run all programs installed on the server, and interact with that server as if you were sitting next to it. The server will provide each concurrent user with his or her own desktop and the ability to run all the applications at the same time.

According to Microsoft, a TS-configured machine can host up to 520 concurrent users, depending on several factors, including its type of microprocessor and hard disk, available memory, network configuration, and the kinds of software it hosts.

Remember that depending on your setup, your employees may be able to use the Remote Desktop to connect to the server over the Internet, no matter where they are. Discuss this with your IT staff, which will likely decide to install a secure virtual private network connection for this purpose.

A more comprehensive installation checklist is available at **www.microsoft.com/windowsserver2003/techinfo/overview/quickstart.mspx**. ❖

AICPA RESOURCES

Do you face challenges like those discussed in this article? Then consider joining the AICPA's IT Membership Section or becoming a Certified Information Technology Professional (CITP). To learn more, go to **www.aicpa.org/infotech** and **www.aicpa.org/CITP**.

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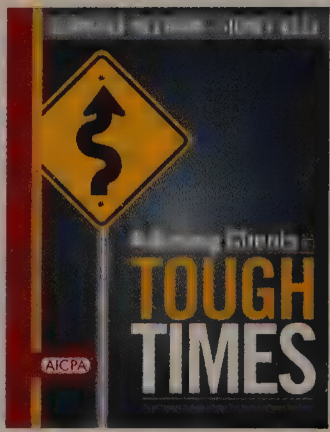
Advising Clients in Tough Times

Do you have the answers to clients' most pressing questions?

by Barbara Weltman, JD and Sidney Kess, CPA, JD, LLM



Includes information on the American Recovery and Reinvestment Act of 2009

We are experiencing an unprecedented financial crisis with access to credit virtually at a standstill, record numbers of people losing their homes, investments and retirement savings being slashed or even wiped out by stock market swings and financial frauds, and the unemployment rate up to a very high level.

These and other money matters are causing concern or even panic among clients of all ages and financial levels. Clients are looking for guidance and reassurance to help them get through this tough economic period with as little downside as possible and to plan for their and their family's future.

When anxious clients turn to you, their CPA, for answers to their questions on money matters and reassurance about their concerns, will you be prepared? How many of these questions are you ready to answer?

Your Client's Home

- Should I buy a home now or wait for better times?
- How much home can I afford?
- What can I do to improve my chances of getting a mortgage (or one that has a low rate)?
- I've locked into a contract for home heating oil this season. Can I get out of it?
- Can I get a home equity loan?

Your Client's Job

- If I'm terminated, am I entitled to my unused vacation days?
- Am I taxed on severance pay?
- My employer is continuing to pay my health coverage for a period of one year after my employment ends. Is this taxable to me?
- What happens to my flexible spending account when I leave the company?
- How do I know whether I'm entitled to COBRA coverage?
- I have a loan from my 401(k) plan. What happens to this when I leave the company?

Your Client's Business

- I need to lay off staff in order to stay afloat. What are my payroll obligations?
- I think I've cut my expenses to the bone. How can I find new ways to save money?
- My lease is about to expire. Should I renew it?
- My bank has reduced my line of credit, but I still need money. Where can I find capital now?
- I am in a service business and one of my customers failed to pay the balance due on a big contract that I completed. Can I deduct the unpaid amount?
- I've suffered substantial operating losses this year. What tax breaks can I claim?

Nervous clients will be reassured when you are ready with immediate and timely answer to the questions weighing on their minds.

You'll find answers to these questions and more, when you order publication On-Demand 029885PDF, Advising Clients in Tough Tim
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Publications

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This collection of articles and white papers combined with commentary will help you develop a better understanding of the coming convergence. This is critical reading for the busy professional who wants to understand the growing attention on IFRS and take practical, timely steps to keep pace with the increasingly global nature of accounting and financial reporting.

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This Webcast On-Demand offers an in-depth analysis of the AICPA's *Compilation and Review 2008 – Risk Alert.* Watch leading practitioners as they provide updates on recent practice issues and professional standards affecting compilation and review engagements.

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Prerequisite: None
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CPE Direct
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Level: Basic
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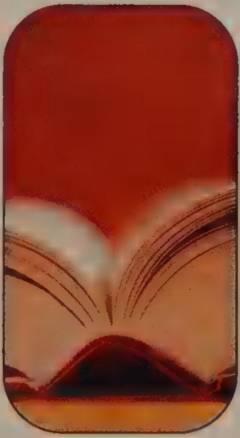
  April 30-May 1, 2009
  Grand Hyatt
  Washington, DC
- **AICPA National CFO Conference**
  May 14-15, 2009
  Hilton La Jolla Torrey Pines
  La Jolla, CA

Web Events

- **The New Stimulus Act … What You Need to Know**
  Webcast On-Demand
  780175
  $59.00
- **Ponzi Schemes, Bernard Madoff and Beyond**
  Webcast On-Demand
  780157
  $59.00

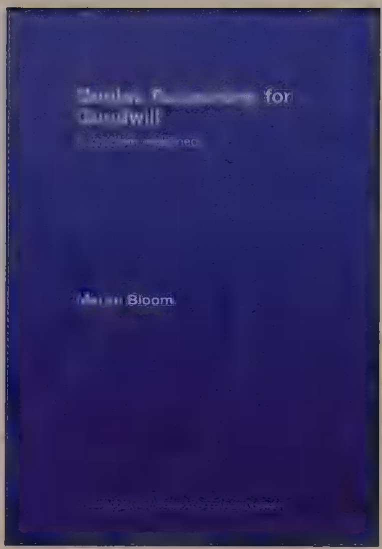


BOOKSHELF REVIEW

Recommended Reading From the *JofA*

■ *Double Accounting for Goodwill: A Problem Redefined*

by Martin Bloom
Routledge, 2008, 248 pp.



This book traces the history of the goodwill accounting controversy in detail. The book explores the problem of recognizing the importance of goodwill as a whole and finding a way of presenting meaningful information regarding it in the context of financial statements.

The author is a senior partner in Deloitte's corporate and forensic accounting practice in Sydney, Australia. After more than 40 years of public practice, he decided to study accounting for goodwill in detail. He became convinced that the conventional accounting treatment of goodwill was unsound in theory and of little use in practice.

The author's proposed solution builds upon his research, which formed the basis of a doctoral thesis at the University of Sydney. He proposes a market capitalization statement based on a modification of 19th century double-entry accounting that puts it in a modern context. Examples show that the proposed market capitalization statement has the potential to provide significant information not currently available from conventional financial statements, which in turn are freed to present clearer information.

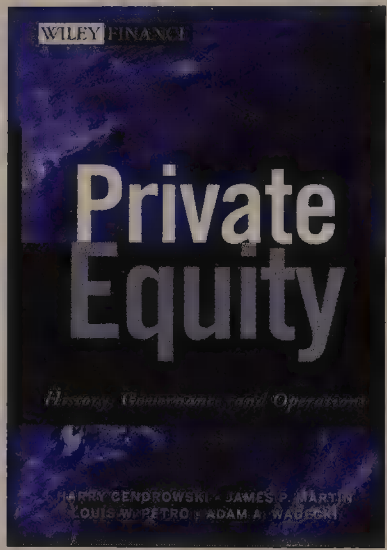
The author readily admits that further research is needed beyond his own work. He contends, however, that accounting for goodwill and identifiable intangible assets is so important that it's critical that the issues surrounding it be resolved.

By JofA *Senior Editor* ***Matthew G. Lamoreaux***

■ *Private Equity: History, Governance, and Operations*

by Harry Cendrowski, James P. Martin, Louis W. Petro and Adam A. Wadecki
John Wiley & Sons Inc., 2008, 457 pp.

The institutionalization of private equity is one of the most important advances in the field of modern finance, write the authors of *Private Equity: History, Governance, and Operations*. "It is through private equity (PE) that the seeds of new ideas are permitted to germinate and the souls of the withering may be granted rebirth." This comprehensive guide provides insight into a once-exclusive form of investing that is now an integral part of the world economy, with a focus on venture capital financing and buyout transactions.



The book is divided into four modules. Module 1 is especially directed toward the novice with an introduction to private-equity terms (with a glossary to help keep them straight), an overview of the structure of the private-equity process and a history of the birth of private equity. Module 2 focuses on the unique governance structures of private-equity firms and how they differ from public corporations. Professional standards, models of internal control and contemporary business intelligence are also covered in this section. Module 3 focuses on improving the operations of portfolio companies, while Module 4 deals with special consideration in private-equity investments.

For novices and experienced investors alike, achieving a better understanding of the complexities of private-equity investing may prove easier with this in-depth resource at your side.

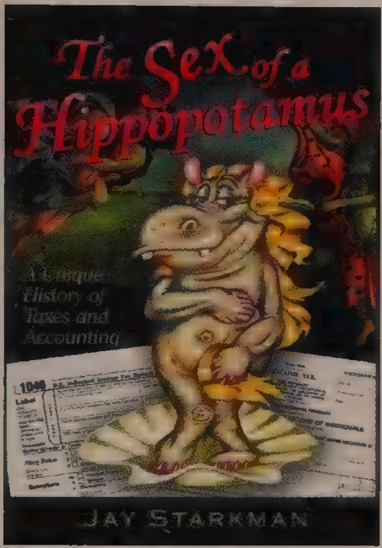
By JofA *Senior Editor* ***Loanna Overcash***

■ *The Sex of a Hippopotamus: A Unique History of Taxes and Accounting*

by Jay Starkman
Twinset Inc., 2008, 456 pp.

The Sex of a Hippopotamus by Jay Starkman is a well-documented and interesting read for professionals in the accounting and tax fields. In particular, this book is appealing to instructors, retirees, recent accounting graduates and the hard-to-buy-for CPA.

The book begins with anecdotes of accounting careers, then documents the role of accounting in the world (with special emphasis on U.S. history), and ends with tax anecdotes of the rich and famous. Career chapters address accounting and pop culture myths such as the long hours ("in every 24 hours, there are three perfectly good eight-hour chargeable days"), strict dress code, charitable requirements and difficult work environment. From *Harry Potter* to the Beatles song "Taxman," artistic depiction of accountants ranges from boring to oppressive. Separating myth from reality takes experience and perspective.



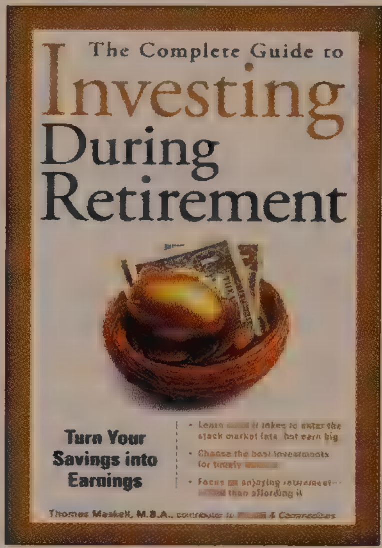
Starkman would know. He is a recognized, practicing CPA in Atlanta with nearly 40 years of work experience in the field including audit, fraud and tax. Having worked for most of the Big Four firms and currently running his own public accounting firm, Starkman can be controversial. He compares the hours of a career in public accounting to the Japanese concept of *karoshi*, which loosely translates to "death from overwork," repeating the saying, "Let's go home while it's still dark." He addresses abusive tax shelters and internal control weaknesses for electronic tax filing. He evaluates changes to professional ethics over time, including changes in the ability to accept referral fees, continuing education requirements and the reliability of prepackaged tax software.

Similarly, the history of tax and accounting is not sugarcoated. He includes a discussion of California's 1850 tax on foreign laborers (primarily Chinese and Latinos), highlights Russian ruler Peter the Great's tax levied on beards, and European taxation of Jews from medieval times through World War II. For better or worse, Starkman names names.

Underneath it all, though, is a strong ethical reckoning. "Can an honest accountant succeed?" asks Starkman (implying the answer is, "Yes, but not without being tested"). Nearly every reader will find some parts of the book drier than others. Accounting historians may trivialize some of the personal experiences, whereas practitioners may only be generally interested in the Turkish capital tax. But there is enough of each area of accounting to make buying this book worthwhile and its reading enjoyable.

By ***Valrie Chambers****, CPA, Ph.D., associate professor of accounting, Texas A&M University–Corpus Christi*

■ ***The Complete Guide to Investing During Retirement***
by Thomas Maskell
Adams Media, 2009, 256 pp.



If you, or a client, have reached retirement age with only a modest savings for retirement, this book is for you. With no market experience, former engineer Thomas Maskell started his investing career during retirement and learned the business of buying and selling stocks from the ground up. Now he shares that knowledge so others can get into the game.

According to Maskell, a retiree's chances for success are enhanced, not hurt, by a market collapse. Yet fears of risk may deter them from entering the market at such a late stage. He warns that by keeping a tight grip on what little savings they do have, retirees are losing money. "It is time to defeat the fear standing between you and financial success," Maskell declares.

The book defines stock market terminology and procedures in layman's terms and explains its associated risks and rewards. A self-assessment exercise helps readers determine the kind of market players they will be (investor, stock trader or speculator) and develop their strategy accordingly.

Readers will learn to develop a stock-analysis regimen, "spot cause and effect relationships…to profitably predict stock price movements," and develop the confidence to recognize market opportunities and how to react to them.

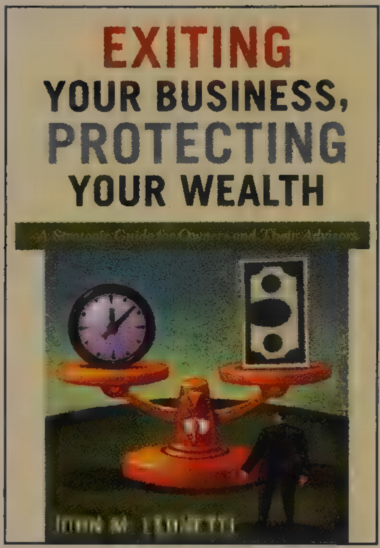
By JofA Senior Editor ***Loanna Overcash***

■ ***Exiting Your Business, Protecting Your Wealth: A Strategic Guide for Owners and Their Advisors***
by John M. Leonetti
John Wiley & Sons Inc., 2008, 238 pp.

Private business owners who need a business exit strategy should read *Exiting Your Business, Protecting Your Wealth*. With considerable experience in the realm of exit planning, author John Leonetti helps business owners assess their exit readiness in order to choose the option best suited for their level. This book is not about selling your business. "Believing that an exit strategy is simply the sale of your business is a major trap to avoid," Leonetti writes. Through a fictional exiting owner named Bill, readers get to explore various exit options and understand how his decisions affect the overall

outcome of each strategy.

Exit options include:



- **_Selling the business._** This option may provide the highest return, but taxes and fees generated by the sale often reduce the final amount of money received by the owner.
- **_Private-equity group recapitalizations._** Through an employment agreement, the owner maintains operational control while selling off a majority of the business. Owners can continue to receive income and participate in future deals.
- **_Employee stock ownership plans (ESOPs)._** This option allows an owner to maintain control while gaining some liquidity and diversification. ESOPs can be customized, combined with other options and/or implemented over several years.
- **_Management buyouts._** Passing a business along to a management team might be an option for owners who are financially prepared for their future.
- **_Gifting programs._** This option is best suited for owners who do not want to extract a financial value from their business but instead want to give it to family, employees or charities while limiting tax liabilities.

Regardless of the exit option chosen, technical components will impact the net amount an owner receives. Leonetti's book can assist owners (and those who advise them) in choosing the best strategy to protect the wealth of their business while allowing them to choose either an active or inactive role in its future.

By JofA Senior Editor ***Loanna Overcash***

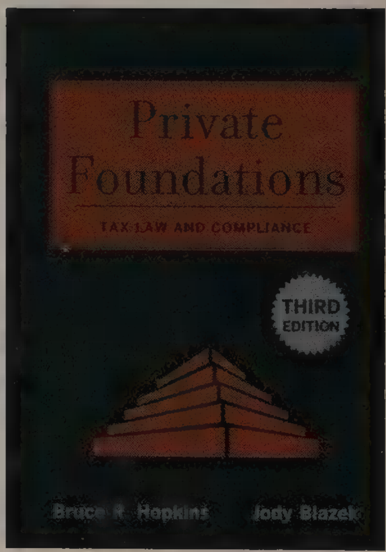
■ *Private Foundations: Tax Law and Compliance,* Third Edition

by Bruce R. Hopkins and Jody Blazek
John Wiley & Sons Inc., 2008, 768 pp.

Only about 75,000 private foundations exist in the U.S. But like the people who create them, they exert an influence far beyond their numbers. Mostly, they do so by their largesse. Including community foundations, they distributed $36.5 billion in 2006, more than 12% of all charitable giving. Also, smaller family foundations have been increasing in number and volume of spending. Or at least they were before the current recession.

Private Foundations, part of Wiley's Nonprofit Series, is a handy how-to reference for stewards of these charitable arms, bound as they are by the IRS Code and regulations. The book's dual legal and accounting approach seamlessly reflects the teamwork of lawyer Bruce R. Hopkins, with his expertise representing tax-exempt organizations, and CPA Jody Blazek, with a similar specialty. Blazek has chaired and served on several AICPA committees on tax-exempt organizations. Both have written extensively on nonprofits, both together and separately.

The book is organized with an eye to procedural questions, from organizing and applying for tax-exempt status to managing mandatory distributions, to reporting annually to the IRS, to winding up a foundation's affairs. Throughout, the authors provide checklists and samples of letters, reports and IRS forms, schedules and attachments. They give tips on navigating such hazards as an IRS examination, correcting a sanctionable error and seeking reasonable-cause abatement of excise taxes. They include a distribution timing plan for minimizing excise tax on investment income and a checklist for establishing reasonability of compensation to disqualified persons, an essential monitoring task if foundations are to avoid self-dealing penalties.



The book also helps readers understand the place of private foundations within the realm of tax-exempt charitable organizations and the historical background for their regulatory regime, comparing them with public charities and—particularly timely—setting forth the currently evolving strictures on donor-advised funds. Beyond helping foundations toe the legal line, the authors advise on administrative considerations as easily overlooked as state disclosure requirements for nonprofit corporations and as novel as how to use the Internet to best advantage.

As they note in a preface, keeping such a book updated with changes in tax law can be frustrating.

If it were only that easy. Investment losses that steepened in October 2008, when the book was released, have no doubt wrought still more momentous change. While guidance on what constitutes proscribed "jeopardizing investments," for example, remains fairly settled, it's safe to say that foundations have experienced some jeopardy, and from quarters neither they nor the IRS expected.

By JofA Senior Editor ***Paul Bonner*** ❖

TAX PRACTICE CORNER

Representing Clients With Tax Delinquencies and Deficiencies

It's not unusual for CPAs to encounter clients delinquent in filing individual, corporate or payroll returns. CPAs can establish a rewarding practice niche if they are prepared to offer a full range of tax resolution options and be a trusted ally to clients who need to atone for their lapses and get right with Uncle Sam.

This work often involves preparing a number of prior-year tax returns. It requires knowledge and research of changing tax laws, the use of tax software from prior years, the interpretation of IRS taxpayer transcripts, and the ability to reconstruct income using various sources such as Freedom of Information Act (FOIA) requests. It requires CPAs to understand administrative tax law and learn new ways of client management. Thus it demands specialized skills that should command higher-than-usual hourly rates and often requires many billable hours.

Potential Criminal Problems

The CPA must be vigilant for any indications that clients are involved in willful tax evasion other than by not timely filing or paying their taxes (for example, not reporting illegal income, using fictitious Social Security numbers or filing as a tax protester). If there is even the slightest suggestion that the client has committed an illegal act, immediately stop the interview and have the client call a tax attorney. You must prevent the client from revealing any potentially incriminating information. The client needs legal representation, and if you are to continue working on the case, you need to be retained by the attorney under a "three-corner agreement."

Engagement Letter

Before representation begins, it is imperative that an engagement letter be completed and signed. The letter should address which current and past-due tax returns will be prepared and which tax resolution procedure—such as a payment plan, a request for an abatement of penalties, innocent spouse relief or an offer in compromise (OIC)—you expect to pursue. It should also state your estimated fee and that:

- The fee will be based on the actual hours worked.
- You will provide progress billings.
- A retainer of a certain amount (as large as possible) will be required before any work is performed. You should also complete an IRS power of attorney, Form 2848, covering the current year and all open years. You must indicate on it which tax forms you are representing the client on. It may be advisable to include forms that might later need to be added. A separate power of attorney should be completed for corporations and other entities with a federal identification number.
- A positive retainer balance must be maintained at all times for you to continue representing the client. Even though it may take months for the IRS to start working on the taxpayer's case, once it does, you will be required to respond quickly.
- If any required retainer payment is not timely received, your power of attorney will be promptly revoked.

The engagement letter should also include a statement that while you will represent the taxpayer to the best of your ability, you cannot guarantee favorable results. While IRS decisions may be subject to appeal, the final results are beyond your control.

Information Needed

You will need to obtain transcripts of account (also known as a record of account or summary record of assessment) and "payer transcripts" (which include forms W-2, 1099, 5498, etc.) for at least the prior 10 years. To the extent there has been any prior audit or collection activity, a FOIA request should be used to obtain copies of IRS files so that the CPA is aware of the IRS' prior interaction with the client. If the client has filed a tax return for the three prior processing years, the CPA should request a "return transcript," which reflects summary information from the return.

The IRS usually has 10 years from the date of assessment to collect delinquent taxes by levy or proceeding in court (IRC § 6502(a)(1)). Assessment does not occur until the returns have been filed and processed by the IRS and the assessment appears in the Transcript of Account, which is a computer-generated or manually prepared register that is signed by an IRS assessment officer. However, a new 10-year assessment period commences on the date of the assessment of the audit liability, if the return is examined within the applicable statute of limitations for examination and assessment (generally three years—Treas. Reg. § 301.6502-1(a)). In addition, the 10-year collection period is tolled during the offer-in-compromise (OIC) period from the date of filing until the date the offer is accepted or rejected (section 6331(k)(3); Treas. Reg. § 301.7122-1; also see Form 656). Moreover, the collection statute is suspended when the taxpayer's assets are in the control or custody of any court, during any bankruptcy proceedings and for six months after bankruptcy proceedings have terminated (Treas. Reg. § 301.6503(b)-1). The exact date that the statute of limitations

commenced, both for assessment and collection, as well as the date of all assessments, may be ascertained from the taxpayer's transcript.

Once the transcript is received, you will need to:

- Compare the tax liability stated on the returns provided by the client to the assessed tax liabilities shown on the transcript and note any differences.
- Compare any amounts shown as paid per the transcript to the amounts shown as paid per the client's tax returns, plus any additional amounts paid after the returns were filed. Note any discrepancies, including the correct application (to the appropriate year) of payments made subsequent to filing.
- Check the dates filed, the dates of tax assessment, collection expiration dates, etc. It is possible that some of the taxpayer's liability may be close to expiration of the 10-year statute of limitations for collection by the IRS.
- Summarize by year the remaining tax liabilities and the interest and penalties added by the IRS. The payer information will give you information as to employment, income, investments and deductions/liabilities.

Negotiating With the IRS

Before you can begin most tax resolution negotiations with the IRS, clients must have filed all open tax returns and have paid their estimated tax liability for the current year. This determination will usually require preparing a current-year tax projection. For clients who have not fully paid their estimated tax liability, establish a plan that will not only bring them current as soon as possible but will also keep them current during the negotiation period. For example, the client may need to make a lump-sum estimated tax payment with Form 1040-ES, *Estimated Tax for Individuals*. Clients also may need to increase their payroll withholding or increase their quarterly estimated tax payments.

Self-employed taxpayers may need to make estimated tax payments more often than quarterly to coincide with their cash inflows. For instance, self-employed real estate agents might be instructed to pay their estimates each time they receive a commission check.

According to the Internal Revenue Manual (IRM 20.1.1.3.1), penalties and the interest computed on penalties may be abated if the taxpayer can demonstrate a "reasonable cause" (such as mental illness, medical problems or the death of a spouse) for failing to file or pay. Frivolous tax return filers and clients under criminal investigation should be handled by a tax or criminal attorney.

IRC § 7122 permits the IRS to settle a taxpayer's liability for less than the balance due if the taxpayer submits an OIC. The OIC process, which may take many months, involves submission of completed IRS forms 656 (*Offer in Compromise*), 433-A (*Collection Information Statement for Wage Earners and Self-Employed Individuals*) and/or 433-B (*Collection Information Statement for Businesses*). Form 433 is used to determine how much the taxpayer can afford to pay, as well as the availability of assets that can be seized. The form requires the client to submit receipts for the last three months' living expenses.

A taxpayer whose offer is accepted must remain in compliance with all future tax filings for five years, beginning with the calendar year that follows acceptance of the offer (see Form 656, Section V(d)). If taxpayers default in their compliance obligation, the statute of limitations renews and the IRS will begin a collection action to collect the original assessment plus interest and penalties.

Remember that the assessment and collection statute of limitations doesn't apply to unfiled tax returns. Thus, while the IRS may administratively require the taxpayer to file only the last six years of past-due returns, clients who do not file all open returns may be exposed to subsequent IRS collection efforts and may not be able to file an OIC, since they will not be considered "current." To "clean the tax slate," file all open returns and include in the OIC all amounts owed. With an OIC, generally all unfiled returns must be filed.

If the client is not eligible for an OIC, you may want to consider filing a request for abatement of penalties and interest on such penalties. The IRS cannot abate the interest or penalties computed on unpaid taxes except through an OIC or pursuant to one of the reasons stated in section 6404. Generally, for interest, there must have been an unreasonable error or delay by an IRS officer or employee acting in his or her official capacity in performing a ministerial or managerial act. For penalties, incorrect information must have been given in writing to the taxpayer by the IRS office or employee who assisted the taxpayer with the return, and the taxpayer must have relied upon that information.

Have the client provide you with a copy of all tax returns filed during the past 10 years. If the client filed a return but failed to keep a copy, use Form 4506, *Request for Copy of Tax Return*. A $57 fee is charged for each return.

A Rewarding Niche

Once you have helped a client resolve his or her IRS tax problem, you often have a loyal, long-term client and a great source of referrals. After all, prior to your assistance, the client felt like a criminal.

The next time you are confronted with a client who needs help with a tax problem, consider entering this interesting and financially rewarding area of tax practice. Tax resolution representation provides a valuable, much-demanded client service. Let's not leave this important tax work to some of the advertisers of such services who may lack the necessary competence to effectively resolve the client's problem.

*By **Donald L. Ariail**, CPA, DBA, **Michael M. Smith**, Esq., CPA, and **L. Murphy Smith**, CPA, DBA. They can be reached, respectively, at ariailcpa@aol.com, mmsmith@bakerdonelson.com and lmsmith@mays.tamu.edu.*

TAX MATTERS

PARTNERSHIPS

PARTNER-LEVEL DEFENSE RULE HELD VALID

The Tax Court upheld the validity of temporary regulations requiring a partner to raise partner-level defenses to penalties in separate litigation after resolution of unified partnership proceedings.

Andrew Filipowski created New Millennium Trading LLC in 1999 to generate a deductible loss through the use of foreign currency options. In 2005, the IRS determined that the partnership and the transactions were shams. It denied the deductions and assessed penalties under section 6662. Filipowski raised partner-level defenses against the penalties during the partnership-level litigation, and the IRS objected to their consideration.

Treas. Reg. § 301.6221-1T, in subsections (c) and (d), states that partner-level defenses may be raised only in separate litigation for refund following payment by the partner of the tax and penalty due. The taxpayer argued that these regulations were invalid because they denied the Tax Court the authority to hear penalty cases and because they were an invalid and unreasonable interpretation of section 6221. However, the Tax Court found that Congress amended the law in 1997 to provide that a partner, in the court's words, "may raise partner-level defenses only in a refund action filed after the close of partnership-level proceedings." Therefore, the regulations did not deny the Tax Court any authority granted to it by Congress, the court said.

To analyze the taxpayer's argument against the validity of the regulations, the Tax Court had to determine which standard for review to apply. Since any appeal would be to the Court of Appeals for the District of Columbia Circuit, the court applied the *Chevron* standard adopted by that circuit. Under *Chevron*, regulations are upheld unless they directly conflict with the Code or are an unreasonable interpretation of an ambiguous Code provision. Since Code §§ 6221 and 6230, taken together, are unambiguous that partner-level defenses are to be raised by refund suits and the regulation is consistent with this rule, the regulation is valid, the court said. Following the partnership litigation, the partner must pay the tax and penalty and then sue for a refund to raise partner-level defenses. The Court of Federal Claims has decided the issue similarly in two cases, *Stobie Creek* and *Jade Trading* (respectively, 101 AFTR2d 2008-1151 and 100 AFTR2d 2007-7123; see also "Tax Matters: Levels of Certainty," *JofA*, July 08, page 86).

■ *New Millennium Trading LLC v. Commissioner*, 131 TC no. 18

By ***Edward J. Schnee****, CPA, Ph.D., Hugh Culverhouse Professor of Accounting and director, MTA Program, Culverhouse School of Accounting, University of Alabama, Tuscaloosa.*

Top 10 Foreign Housing Allowances

Qualified U.S. taxpayers living abroad may claim an income exclusion under IRC § 911(a) for housing costs. The standard maximum amount for tax year 2008 is $26,280, but for certain places designated as high-cost relative to the U.S., it is more–in some cases, much more.

Location	Annual Housing Expense Limit
Hong Kong	$114,300
Paris and suburbs Garches, Sèvres, Suresnes and Versailles	$100,100
Milan	$ 99,600
Tokyo	$ 94,200
Moscow	$ 90,900
Bermuda	$ 90,000
Geneva	$ 84,100
London	$ 82,900
Sakhalin Island, Vladivostok (both in Russia)	$ 77,500
Caversham (U.K.)	$ 73,800

Source: IRS Notice 2008-107, 2008-50 IRB.

CHARITABLE CONTRIBUTIONS

IRS, HISTORIC HOTEL FACE OFF OVER FACADE

The Tax Court held that the Uniform Standards of Professional Appraisal Practice (USPAP) are not the sole measure of an expert witness's reliability. The witness had been called upon to provide a value of a conservation easement restricting the use of real property, or "servitude." Based on that testimony, the court upheld the Service's denial of the full claimed value of the servitude as a deduction for a charitable contribution.

Whitehouse Hotel, a limited partnership, purchased Maison Blanche, a historic building near the French Quarter of New Orleans, and adjoining property.

Whitehouse developed the parcel into a hotel operated by Ritz-Carlton. It also transferred to the Preservation Alliance of New Orleans a conservation servitude guaranteeing to maintain the historic appearance of the building's facade in good condition. Whitehouse claimed on its 1997 federal income tax return a charitable contribution deduction for $7.44 million, the amount an appraiser determined as reflecting the property's reduction in value by the servitude. The IRS determined that the allowable deduction should have been $1.15 million.

Both Whitehouse and the IRS used expert witnesses at trial. Whitehouse argued that the government's expert was disqualified because (1) he was not experienced with this type of transfer and (2) his report did not conform with USPAP, since he used only the sales approach, rejecting the cost and income approaches.

In answer to the taxpayer's first objection, the court held that the government's expert, while having limited experience with this type of transfer, did have experience valuing property encumbered with a restriction. Furthermore, Whitehouse failed to distinguish between various types of property restrictions, the court said. On the second objection, the court held that while compliance with USPAP is an indicator of reliability, trial judges bear the responsibility of determining the reliability of an expert witness's testimony. Whitehouse argued that USPAP should be the sole indicator of reliability. The court held that an expert's opinion that does not fully comport with USPAP may still be admissible, even if it might not prove helpful.

The court found the report by the government's expert to be the more reliable and held for the IRS. Furthermore, the court imposed the 40% penalty for gross valuation misstatement (greater than 400% difference) and held that Whitehouse did not qualify for the reasonable-cause exception. The taxpayer appealed the decision to the Fifth Circuit on Jan. 27.

■ *Whitehouse Limited Partnership v. Commissioner*, 131 TC no. 10

By ***Michael H. Brown****, associate professor of accounting, Millikin University, Decatur, Ill.*

TRANSFER PRICING

P&G APPEALS DEDUCTION DENIAL

In a case on appeal before the Sixth Circuit, household consumer goods manufacturer Procter & Gamble (P&G) and a related entity claim a refund of taxes paid on a foreign sales corporation (FSC) advance payment transaction (APT). The U.S. District Court for the Southern District of Ohio had denied the claim by P&G and P&G FSC, which is based on a claimed deduction of more than $362 million for tax year 2000.

P&G, P&G Canada, and P&G FSC are related entities but file separate tax returns. During tax year 2000, P&G Canada made a $374,790,000 advance payment to P&G FSC. P&G FSC, in turn, made a $288,588,300 advance payment and an interest-free loan of the difference—$86,201,700—to P&G. P&G FSC reported sales income of $374,790,000 attributable to the APT, while P&G reported only $288,588,300 (the transfer price) in sales income on its tax return.

The manufacturing cost of the products subject to the APT was $359,344,974. P&G and P&G FSC calculated combined taxable income (CTI) by adding P&G FSC's gross receipts for the APT and not subtracting any of the $359,344,974, on the rationale that the costs were not incurred until tax year 2001. P&G reported these costs as cost of goods sold on its 2001 tax return. P&G also reported a net loss of $70,756,674 on its 2000 and 2001 tax returns in connection with the APT.

The essence of the transactions was to allow the taxpayers to shift the difference between the gross receipts and the transfer price to P&G FSC, which P&G FSC reported as a profit. Under the now-repealed FSC rules, the taxpayers were allowed to exempt 23% of their CTI permanently from tax under IRC §§ 921 and 923. The amount excluded equaled the profit reported by P&G FSC.

During its audit, the IRS determined that the transfer price was based on a CTI calculation that did not include total costs, thereby violating the FSC administrative pricing rules and resulting in an understatement of P&G income of $86,201,700.

IRS' calculation of CTI:

Gross receipts	$374,790,000
Less: Cost of goods sold	359,344,974
Less: Other costs	2,721,689
CTI	$ 12,723,337

The IRS assessed P&G for the understatement. P&G paid the assessment and sought a refund of the taxes at the administrative level. When the claim was denied, the taxpayers sought judicial review under IRC § 7422.

In a 2007 opinion, the district court found that because of the huge disparity between the arm's-length price of $374,790,000 and the transfer price of $288,588,300, as a matter of law, the prices could not be viewed as an approximation of each other. The court concluded that the transfer price ran counter to legislative intent, which was to limit the FSC exemption to an approximation of an arm's-length price in compliance with the General Agreement on Tariffs and Trade. The court ruled that the taxpayers' calculation of CTI violated the FSC administrative pricing rules. The taxpayers filed a motion to clarify and modify the court's 2007 opinion.

In its 2008 opinion, the court addressed only whether the taxes should have been calculated under the gross receipts method of determining CTI, as proposed by P&G, or under the arm's-length pricing method, as used by the government in its calculation. According to P&G's calculation, under the gross receipts method, its deduction would have been $362,066,663 for tax year 2000. However, the court found that because P&G failed to submit these calculations under the gross receipts method when it initially filed its administrative refund claim, it was barred under the variance doctrine from asserting this claim at the judicial level. The court rejected P&G's argument that the government waived the variance doctrine defense when it first advanced at the judicial level its argument that P&G miscalculated CTI in violation of the administrative pricing rules. The court reasoned that even though the government did not expressly assert this miscalculation at the administrative level,

P&G should have anticipated that the government would challenge its failure to take total costs into account when calculating CTI.

P&G also argued that P&G FSC did present the gross receipts method alternative in its refund claim. However, the court admonished P&G for attempting to "ride on the coattails" of a claim made by P&G FSC, since P&G and P&G FSC are treated as separate taxpayers, file separate returns, report separate income items and, most important, make separate refund claims. As a result, the court ruled that it lacked jurisdiction to consider P&G's request for the $362,066,663 deduction for tax year 2000.

In its appeal brief before the Sixth Circuit, P&G argued that the district court's summary judgment was incorrect because it did not consider whether the IRS correctly assessed tax according to the Service's arm's-length position under section 482, among other reasons. The government's appeal brief countered that the District Court correctly held that P&G's transfer price was understated because its computation did not account for the total costs of the APT. P&G requested oral arguments, which had not been scheduled by press time.

■ *P&G v. United States*, 100 AFTR2d 2007-6241 and 102 AFTR2d 2008-5138, *appeal docketed* no. 08-4078 (6th Cir.)

*By **Jean T. Wells**, CPA, J.D., assistant professor of accounting, Howard University, Washington, D.C.*

S CORPORATIONS

CAPITAL CONTRIBUTIONS INCREASE STOCK, NOT LOAN BASIS

Two brothers' additional capital contributions to S corporations of which they were shareholders could not offset their ordinary income from payments for loans they made to the corporations, the Tax Court held. The court rejected their argument that their capital contributions restored the previously reduced basis of their shareholder loans. Instead, the court held, the contributions increased the taxpayers' stock basis.

Shareholders in an S corporation have an initial stock basis equal to the amount of their capital contributions to the corporation. If shareholders loan money to the S corporation, their loan basis equals the loan amount. Subsequently, under section 1367, the shareholders' stock basis is increased for their share of the S corporation's items of income, including tax-exempt income, and is decreased (but not to less than zero) for their share of any loss items. If the stock basis has been reduced to zero, any additional loss items will decrease (but not to less than zero) the shareholders' basis of loans made to the S corporation. Later, if items of income exceed loss items, the net increase first increases and restores the basis of the shareholder loans. Distributions to shareholders exceeding the basis of their stock will result in the recognition of capital gain, but loan repayments to the shareholders exceeding their loan basis will result in ordinary income.

Two brothers, Ira and Sheldon Nathel, each owned 25% of the stock of three S corporations, G&D Farms Inc. (G&D), Wishnatzki & Nathel Inc. (W&N) and Wishnatzki & Nathel of California Inc. (W&N CAL). The brothers also made loans to G&D and W&N CAL. As of Jan. 1, 2001, losses had reduced each brother's stock basis and loan basis in the S corporations to $0 and $116,150, respectively. During 2001, each brother received loan repayments of $649,775 from G&D and $161,250 from W&N CAL. The payment from W&N CAL was made as part of a reorganization of the three corporations that resulted in each brother's becoming a 50% owner of W&N, the liquidation of W&N CAL and the termination of the brothers' interests in G&D. Also as part of this process, the brothers each made capital contributions of $537,228 to G&D and $181,396 to W&N CAL. When filing their 2001 federal income tax returns, each brother increased his loan basis by $718,624 (the amount of their 2001 capital contributions) on the theory the capital contributions were an item of income under section 1367—in other words, tax-exempt income. The IRS stated no such increase is permitted and assessed deficiencies against both taxpayers.

After petitioning the Tax Court for relief, the brothers argued the loan basis increase was proper since the capital contributions were an S corporation tax-exempt item of

Return Preparer Fraud Prosecutions Increase

While the number of tax preparers subject to indictments/bills of information and sentenced increased in 2008, the number of new investigations decreased.

Courts also have issued more than 290 permanent injunctions against abusive tax scheme promoters and abusive return preparers since 2001.

	FY 2006	FY 2007	FY 2008
Indictments or bills of information filed	136	131	142
Defendants sentenced	109	123	124
Investigations begun	197	218	214

Source: IRS, Fact Sheet 2009-7.

income. They based their argument on the 2001 holding in *Gitlitz v. Commissioner*, 531 U.S. 206. In it, the Supreme Court held that income from the discharge of an insolvent S corporation's debt under IRC § 108(a) results in a positive stock basis adjustment. The Supreme Court further stated that "§§ 101 through 136 employ the same construction [as § 108] to exclude various items from gross income." Since capital contributions are excluded from income under section 118, the brothers argued that their capital contributions were an item of income that should increase the basis of their loans.

The Tax Court disagreed, stating such an interpretation would contradict three long-standing tax principles: (1) capital contributions of shareholders increase stock basis, (2) capital contributions are not income of the corporation and (3) debt and equity are two different things treated differently by the Tax Code and courts. Furthermore, Treas. Reg. § 1.118-1 states that capital contributions are not income to the recipient corporation. Since loan proceeds and capital contributions are not items of income, they cannot increase an S corporation shareholder's loan basis, the Tax Court said.

Note: In the Job Creation and Worker Assistance Act of 2002, Congress amended section 108(d)(7)(A) and thus overturned the Supreme Court's decision in *Gitlitz*.

■ *Ira and Tracy Nathel v. Commissioner, Sheldon and Ann Nathel v. Commissioner*, 131 TC no. 17

*By **Charles J. Reichert**, CPA, professor of accounting, University of Wisconsin–Superior.*

INCOME AND DEDUCTIONS, STATE TAX

LOCATION TAX INCENTIVE NOT FEDERAL TAXABLE INCOME

The IRS said in a coordinated issue paper that a location tax incentive paid or credited to a business by a unit of state or local government is not included in the business's gross income but rather reduces its tax expense. A location tax incentive is a tax reduction by abatement, credit, deduction, rate reduction or exemption given to a taxpayer as an incentive to locate in, remain in or expand its operations in a particular area. These incentives are not considered purchases from the taxpayer because they do not require the taxpayer to provide any services or property to the taxing jurisdiction. They benefit the taxpayer but are provided primarily for the economic benefit of the community at large. The taxpayer also does not realize an accession to wealth resulting in gross income.

Some corporate taxpayers have argued that such rebates should be treated as an exclusion from taxable income as a nonshareholder contribution to capital under IRC § 118, while they also include them in the full amount of tax expense deductible under section 164, the IRS said. These taxpayers would then reduce their basis of property under section 362(c) by the amount of the purported nonshareholder capital contribution. IRC § 118(a) does allow the money or value of property given to the corporation by the government or a civic group to be excluded from gross income (IRC § 61) as a nonshareholder contribution to capital. However, since a tax rebate is more like a discount on a liability than new incoming money or property, it is not a nonshareholder contribution to capital, the IRS said.

Even if such incentives were otherwise deemed to be gross income, they still generally would not be eligible for IRC § 118 treatment, which requires taxpayers to meet five factors, the IRS said, citing *U.S. v. Chicago, Burlington & Quincy R.R. Co.* (412 U.S. 401, 413 (1973)): (1) The contribution must become a permanent part of the transferee's working capital structure; (2) the contribution must not be compensation for specific, quantifiable services provided by the transferee to the transferor; (3) the contribution must be bargained for; (4) the asset transferred must result in a benefit to the transferee commensurate with its value; and (5) the asset transferred ordinarily, if not always, will be used to produce additional income. (For treatment of a state location incentive *grant* analyzed by these factors and deemed to qualify as a contribution to capital, see Private Letter Ruling 200901018 issued Jan. 2.)

Under the *Chicago, Burlington & Quincy R.R.* rules, a tax incentive is a planned recovery of operating expenses, not a new contribution to the taxpayer's working capital. A factual inquiry would have to be done to determine whether the contribution was made for specific, quantifiable services, in which case the transaction would be (taxable) sales revenue. Usually, tax incentives are not bargained for but are instead the result of state or local statutory tax provisions. A company would also have to show factually that the benefit enhanced the company by more than the amount of the payment deemed as income. If the benefit is used for operating expenses, it is not a long-term investment consistent with owners' equity accounts, and it will not be considered to produce additional income for the company.

Also, since location tax incentives are not ordinarily used to purchase property but instead simply to reduce state and local tax liability, they are not capital expenditures. Instead, they lower the periodic expense of paying state and local taxes. As such, the basis of corporate assets would not be reduced as a nonshareholder capital contribution under IRC § 362(c)(1) or (2), the Service said.

The incentive is also not deductible under IRC § 164 for local, state or foreign taxes paid or accrued during the tax year. The "all-events test" under IRC § 461 allows for a deduction in the tax year in which all the events occurred that determine the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred. See Treas. Reg. §§ 1.461-1(a)(2) and 1.461-4(a)(1). Consequently, since location tax incentives are a reduction of state and local tax expense, only the tax liability net of the rebate is deductible for federal tax purposes.

■ Coordinated Issue Paper LMSB-04-0408-023, *State and Local Location Tax Incentives* (effective May 23, 2008)

*By **Brian Elzweig**, J.D., LL.M., assistant professor of business law, and **Valrie Chambers**, CPA, Ph.D., associate professor of accounting, both of Texas A&M University–Corpus Christi.*

EXEMPT ORGANIZATIONS

DEMOCRATS KEEP EXEMPTION

In the waning days of the Bush administration, the government ended its long-running effort to retroactively revoke the tax-exempt status of a Democratic Party-affiliated organization that it claimed had improperly promoted the party's candidates.

In 1985, prominent members of the Democratic Party including then-Gov. Bill Clinton formed the Democratic Leadership Council (DLC) to promote social welfare and to bring about "civil betterments and social improvements." The DLC applied for tax-exempt status as a social welfare organization, explaining that it was organized by individuals concerned about national policy and the direction of policy debate within the Democratic Party. The DLC intended to create task forces, contract for studies and host fundraising events. It would also hold town meetings, issue forums and policy meetings. It said it would not intervene in campaigns or seek to influence voter perceptions. The IRS granted the DLC tax-exempt status under IRC § 501(c)(4). Courts have allowed 501(c)(4) organizations to engage in political activities if they operate primarily to bring about social improvements.

During 1997, 1998 and 1999, the DLC hosted prominent Democratic elected officials at conferences and held events attended exclusively by Democrats. The president of the DLC stated that its activities were efforts to shift the Democratic Party's policies closer to its own policies, which could help Democrats at the polls.

In 2002, the IRS issued a proposed adverse action letter revoking the DLC's tax-exempt status for 1997 and 1998 because, it said, the DLC was primarily benefiting a private group—newly elected Democrat officials and the Democratic Party—rather than the community. In 2003, the IRS proposed to revoke the DLC's exempt status for 1999. The DLC paid approximately $20,000 in taxes under protest and filed suit for a refund of the amount in the District Court for the District of Columbia, which ruled in its favor in April 2008. The government appealed to the D.C. Circuit but agreed to a dismissal on Dec. 16, 2008.

The DLC argued that it qualified as a 501(c)(4) organization during the years at issue and that the IRS improperly revoked the exempt status retroactively in violation of Treas. Reg. § 601.201(n)(6). Although the IRS may prospectively revoke an organization's tax-exempt status if the organization no longer qualifies for an exempt purpose, the IRS is subject to restrictions when it attempts to revoke tax-exempt status retroactively. The IRS may retroactively revoke an organization's exempt status only if the organization omits or misstates a material fact or operates in a manner materially different from that originally presented.

The IRS claimed the DLC's later operations did substantially differ from its originally stated purposes. The application did not state that the DLC would attempt to reclaim centrist national policies from Republicans or to help elect a Democrat president, both of which its leaders subsequently stated as goals, the IRS claimed. Also, the government said, there was no evidence that the DLC held town meetings or issue forums or contracted for policy studies.

The court recognized the IRS' primary argument that the elected officials were dominant in the creation, control and policies of the DLC but concluded that the IRS did not provide evidence of material changes in the DLC's operations. Regardless of whether the DLC held town meetings and other intended activities, there was no evidence that it operated in a materially different manner than it had proposed, the court said. The court noted that an IRS agent who investigated the DLC's operations testified that it was operating within the terms of its exempt ruling.

The court said the DLC may have been unworthy of exempt status under 501(c)(4), but the revocation was a clear abuse of discretion, and the DLC was entitled to a refund.

■ *Democratic Leadership Council Inc. v. U.S.*, 101 AFTR2d 2008-1597, *appeal dismissed* docket no. 08-5193 (D.C. Cir. 2008)

*By **Jennifer Haynes**, tax associate, KPMG, and **Allen Ford**, the Larry D. Horner/KPMG Professor of Accounting at the University of Kansas, Lawrence, Kan.*

Line Items

ANNUAL EMPLOYMENT TAX FILINGS ARE OPTIONAL

The IRS issued proposed and temporary regulations under IRC §§ 6011 and 6302 (TD 9440) that no longer mandate annual filings by eligible employers in the reporting and paying of income taxes and Federal Insurance Contribution Act (FICA) taxes withheld from wages. The annual filings, using Form 944, *Employer's ANNUAL Federal Tax Return*, are now optional for eligible employers. As originally issued in January 2006 (TD 9239, REG-148568-04), the rules required eligible employers to file annually rather than quarterly, using Form 941, *Employer's QUARTERLY Federal Tax Return.*

Under Temp. Treas. Reg. §§ 31.6011(a)-1T(a)(5) and 31.6011(a)-4T(a)(4), which are in effect for tax years beginning on or after Jan. 1, 2009, employers that estimate that their annual employment tax liability will be $1,000 or less can contact the IRS to request permission to file Form 944 rather than Form 941. The eligibility threshold of $1,000 may be raised through future guidance.

The rules also create a safe harbor under IRC § 6302 for quarterly filers whose quarterly withholdings exceed $2,500. Previously, a quarterly filer avoided a penalty for failure to make timely monthly or semi-weekly deposits of employment taxes if the aggregate amount of employment taxes for the quarter was less than $2,500 and the amount was paid with a timely filed Form 941. The safe harbor under Temp. Treas. Reg. § 31.6302-1T(f)(4) exempts an employer from the penalty if the employment tax due was less than $2,500 in the current quarter or the prior quarter. The safe harbor is not effective until deposit periods beginning on or after Jan. 1, 2010.

PENALTY ON RETIREES SUSPENDED IN 2009

Required minimum distributions (RMD) from retirement accounts were suspended for 2009, giving seniors a respite from a potential 50% excise tax. The Worker, Retiree and Employer Recovery Act of 2008, PL 110-458, waives the penalty for one year, giving retirees some time to recoup losses from the sharp stock market decline of 2008. Without the waiver, individuals age 70½ and older would be required to withdraw an amount, based on remaining life expectancy, from their traditional IRA, 401(k) or 403(b) accounts. Failure to withdraw the full RMD timely normally results in a 50% excise tax on the amount not withdrawn.

The Act also eases funding requirements for employer-sponsored pension plans and multiemployer plans. Without temporary relief, companies short on cash would be forced to make significantly increased contributions because of large declines in major world markets in the past year.

CROSS-CHAIN SALE RESULTS IN COMPLETE TERMINATION

The Tax Court for a second time rejected an attempt by Merrill Lynch & Co. Inc., as the parent, to use a cross-chain sale by one subsidiary of a subsidiary to a sister corporation to increase its basis in the seller's stock and facilitate a loss on the seller's stock when it, in turn, was sold to an unrelated buyer.

In earlier litigation on the same matter, the Second Circuit Court of Appeals (94 AFTR2d 2004-6119) upheld the Tax Court's decision that the IRS could reclassify the reported stock redemption under IRC § 304 as a sale under IRC § 302(b)(3), which deals with a complete termination of interest (see "Tax Matters: Firm-and-Fixed-Plan Rule Reaffirmed," *JofA*, Feb. 05, page 75). The Second Circuit agreed that the "firm-and-fixed-plan" test applied because Merrill Lynch had a firm-and-fixed plan for its subsidiary, Merrill Lynch Capital Resources (MLCR), to lose control of the second-tier subsidiary. The sale, therefore, was a complete termination of interest under section 302(b)(2). The Second Circuit did, however, remand the case to the Tax Court to allow Merrill's argument, raised for the first time on appeal, that the section 302(b)(3) test for a complete termination required consideration of the parent's ownership interest in the issuing corporations.

In the most recent phase of litigation, Merrill argued it was entitled to dividend treatment because neither the cross-chain sales nor the later sale of MLCR reduced the 100% constructive ownership interest attributed to Merrill, as the parent, in the issuing corporations. The Tax Court disagreed (131 TC no. 19 (2008)). The court said that under section 304, MLCR was the only shareholder whose interest in the issuing corporations had to be tested pursuant to section 302. Because MLCR was completely terminated, the redemption was properly treated as a distribution in exchange for stock under section 302(a).

IRS DROPS WORKPAPERS APPEAL

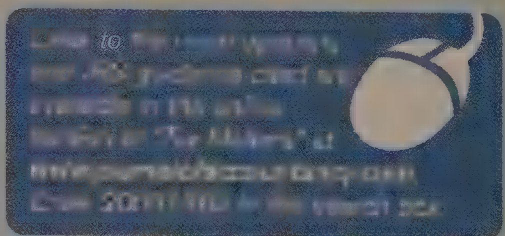
The government abandoned its appeal before the Eleventh Circuit of the decision last year by the District Court for the Northern District of Alabama in *Regions Financial Corp. v. U.S.* that quashed a workpapers summons. In so doing, the court let stand the district court's holding (101 AFTR2d 2008-2179) that the papers were protected by the work product privilege. See also "Line Items: Work Product Stymies IRS Again," *JofA*, Aug. 08, page 88.

AMAZON LOSES ROUND IN N.Y. NEXUS FIGHT

A New York state trial court dismissed Amazon.com's challenge to a law that establishes sales tax nexus through in-state "associates" whose Web sites feature links to the online retailer. Amazon and another Web seller, Overstock.com, separately sued the state's Department of Taxation and state officials last spring after New York extended its definition of "vendor" to include a seller who enters into agreements with in-state parties to solicit business on behalf of the seller by means specifically including Internet links. The law requires such sellers, whether physically present in the state or not, to collect New York state taxes on sales to New York residents. (For previous coverage, see "Tax Matters: Online Retailers Battle N.Y. Nexus," *JofA*, Oct. 08, page 96.)

The Supreme Court for New York County dismissed Amazon's complaint Jan. 12. Amazon had argued that the law violates the U.S. Constitution's Commerce Clause because it imposes tax collection obligations on out-of-state entities that have no substantial nexus with New York. The court, however, said the law passes constitutional muster because it requires a contract between a seller and a New York contractor, referrals by the contractor to the seller, payment of a commission to the contractor and a threshold of $10,000 annually in total sales to New York customers via the arrangement. An arrangement that meets those requirements, such as Amazon's, reflects a "conscious decision" by the seller, and the seller thereby "avails itself of the benefit of in-state contractors compensated for referrals," the court said.

As for whether the arrangement constitutes solicitation by the associates, as opposed to Amazon's characterization of the relationship as merely one of advertising, the court said Amazon doesn't discourage its associates from reaching out to customers "and pressing Amazon sales." Consequently, the court said, it didn't matter that Amazon doesn't expect associates to actively solicit business, or even that associates' contracts prohibit them from offering customer discounts for purchases made after customers "clicked through" to Amazon from their Web sites. ❖

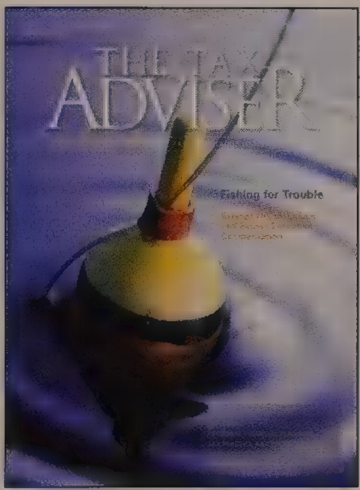


TAX PRACTICE AND PROCEDURE

IRS Alternative Dispute Resolution Programs

The IRS recently extended its fast track settlement program to certain exempt and government entities and announced the establishment of a two-year test of mediation and arbitration procedures for offers in compromise and trust fund recovery penalty cases under the jurisdiction of the Office of Appeals.

TEGE FAST TRACK



The Tax Exempt/Government Entities (TEGE) fast track is modeled closely on the established fast track procedures for Large and Mid-Size Business (LMSB) and Small Business/Self-Employed (SB/SE) taxpayers. The TEGE pilot of its fast track settlement initiative will run for two years. During that period, entities that have unagreed issues in at least one open period under examination can work with the TEGE and the Office of Appeals to resolve the issue while the case is still in TEGE jurisdiction.

The fast track settlement procedures are available to resolve both factual and legal issues at any time after an issue has been fully developed but before the issuance of a 30-day letter (or its equivalent). Announcement 2008-105 identifies issues that will not be available for fast track; however, most issues that arise during an audit will be eligible for fast track consideration. A taxpayer who is interested in participating in the TEGE fast track settlement program should contact the group manager of the examining agent conducting the audit for any periods under examination. Interested taxpayers should also complete the Application for Fast Track Settlement, a copy of which is included as an attachment to Announcement 2008-105 (**http://tinyurl.com/AFTSapp**).

Since fast track issues remain under the jurisdiction of the TEGE division responsible for conducting the examination, any ultimate resolution must be approved by the TEGE.

APPEALS MEDIATION AND ARBITRATION

Announcement 2008-111 establishes a two-year test of the mediation and arbitration procedures for offer in compromise (OIC) and trust fund recovery penalty (TFRP) cases under the jurisdiction of the Appeals Office. During the test period, the appeals officer will offer mediation and arbitration for taxpayers whose appeals are considered in Atlanta, Chicago, Cincinnati, Houston, Indianapolis, Phoenix, San Francisco or Louisville, Ky.

Announcement 2008-111 includes some limitations on the scope of disputes for which mediation and arbitration are available. As an example, neither mediation nor arbitration is available for cases in which the taxpayer has the ability to pay in full based on the unadjusted financial information submitted by the taxpayer, or where the taxpayer has declined to amend or increase the offer without stating any specific disagreement with the valuations or methodology used by Appeals in determining reasonable collection potential.

Mediation is also not available for cases in which the taxpayer has already attempted to resolve the matter through fast track mediation. Arbitration is not available for doubt-as-to-liability cases or corporate OIC cases in which the issue to be arbitrated is whether an individual is responsible for a trust fund recovery penalty or personal liability for excise tax assessment.

For a detailed discussion of the issues in this area, see "IRS Expands Alternative Dispute Resolution Opportunities," by Michael P. Dolan, J.D., in the April 2009 issue of *The Tax Adviser*.

—Alistair M. Nevius, editor-in-chief
The Tax Adviser

Also look for articles on the following subjects in the April 2009 issue of *The Tax Adviser*:

- A look at internal controls for exempt organization compensation plans.
- A discussion of when like-kind exchanges may not be the best idea.
- An explanation of the tax issues in restructuring distressed S corporations.

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Technology Q&A

by Stanley Zarowin

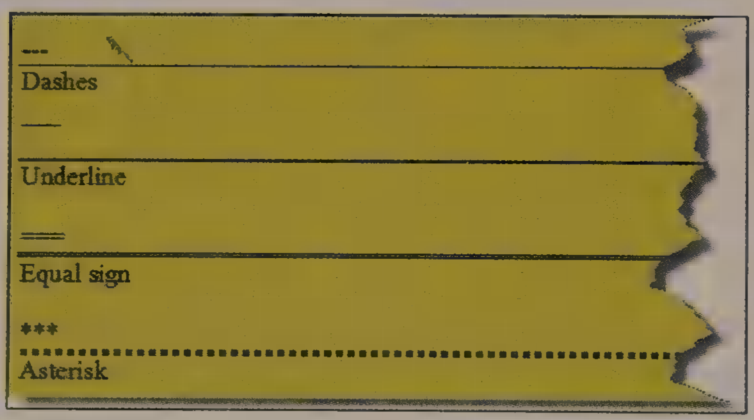
Produce a quick line of dots, dashes or a border–without leaving the keyboard… Discover the power and convenience of Office Clipboard…How to recognize a safe program update invitation…Excel can print an entire file even with a mix of worksheet orientations… A fast way to launch an e-mail…Engage the option: Click inside a word to select the entire word… Inventory your keyboard shortcuts and clear out the useless ones

PRODUCE A QUICK LINE OF DOTS, DASHES OR A BORDER–WITHOUT LEAVING THE KEYBOARD

Q I usually enhance my memos with borders—lines and dashes—but it's a tedious job clicking all those keys. I know I can do it by going to the **Format** menu and clicking on **Borders and Shading**, but that's even more cumbersome. Is there an easier way to do it?

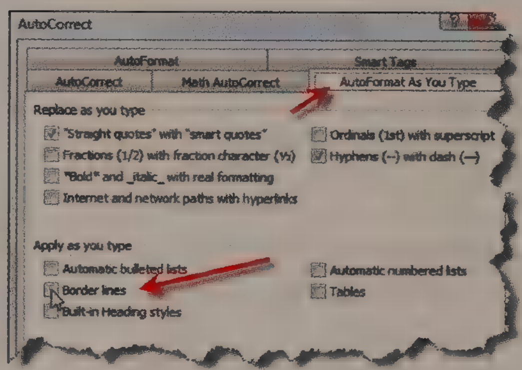
A Yes, there's a really neat way to produce border dashes, bold single or even double or heavy dotted lines—and all that without removing your fingers from the keyboard.

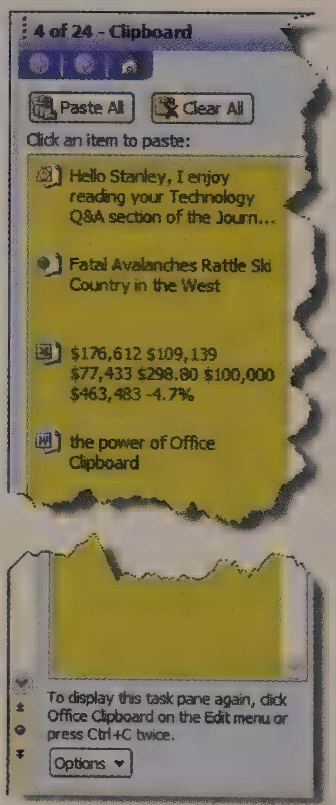
To create a thin line, type three dashes and press Enter. For a bold single line, type three underlines and Enter. For a double line, use three equal signs and Enter. And for a heavy dotted line, type three asterisks and Enter (see screenshot below).



Since each line is actually an entire paragraph, not a line of type, be sure you start at the left margin. You can actually type more than three characters, if you wish, but not less.

The technique works equally well in Word 2007. But if it doesn't, you'll need to make these adjustments: Click the **Button** and **Word Options**. Then click on **Proofing**, **AutoCorrect Options**, opening the **AutoCorrect** dialog screen. Click on the tab **AutoFormat As You Type** and then select **Border** lines (see screenshot at top of next column).





DISCOVER THE POWER AND CONVENIENCE OF OFFICE CLIPBOARD

Q When I copy something in Word, say, with Ctrl+C, and then move on to edit and even copy material in some other part of my document, is there a way to retrieve the snippets I copied for later use?

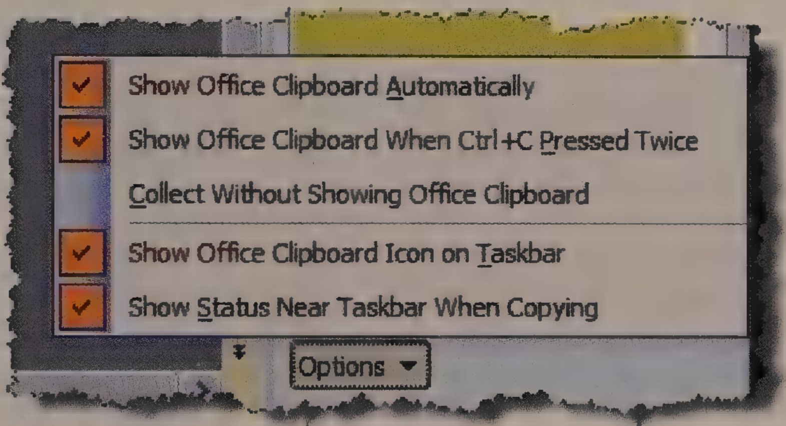
A Absolutely. The tool you need to exploit is the **Office Clipboard**, one of the handiest—and most underused—tools in the Microsoft toolkit. Notice its full name is ***Office* Clipboard**—because it works in combination with all Office applications. And what makes it so handy is that it also works with most third-party apps, too. For example, as the exhibit at left shows, I copied something from a Word document, an Excel spreadsheet, an Outlook e-mail, the online edition of *The New York Times*, and even the graphic program that created this screenshot.

Every time you copy something, it automatically loads into **Clipboard**. To reproduce any of those snippets, just go to an application of your choice, place your cursor where you want it to be copied and then click on the target snippet. Presto! It's placed there.

You can copy a Word snippet into Excel or vice versa.

Of course, **Clipboard** is handy only if it's always available. So I recommend placing it in your toolbar. To do that, click on **Tools**, **Customize**, the **Commands** tab, and then move down to its icon in the **Edit** column and drag it to your toolbar.

To complete the setup to make the **Clipboard** handy, click on **Options** at the bottom of the tool (see screenshot below) and place checks next to the tasks that suit your needs.



In Office 2007 the **Clipboard** switch is right at your fingertips at the left edge of the **Home** ribbon (see screenshot below).

HOW TO RECOGNIZE A SAFE PROGRAM UPDATE INVITATION

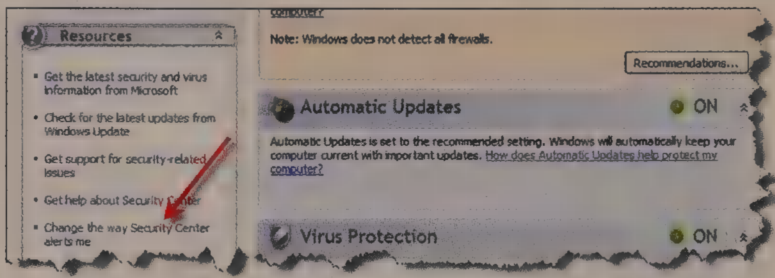
Q When I boot up my Windows XP computer, I keep getting a pop-up above my system tray that says: Updates are ready for your computer. Click here to install these updates. How do I know this is not some kind of virus? There is no indication who is sending them.

A You're wise to be cautious. I assume you're running antivirus software and that it's kept current. But to respond to your question: If the pop-up balloon is directly over a small yellow shield icon in the taskbar, then it's coming from Microsoft, and it's safe. If you right-click on the shield icon, it will tell you how many updates it has for you to install.

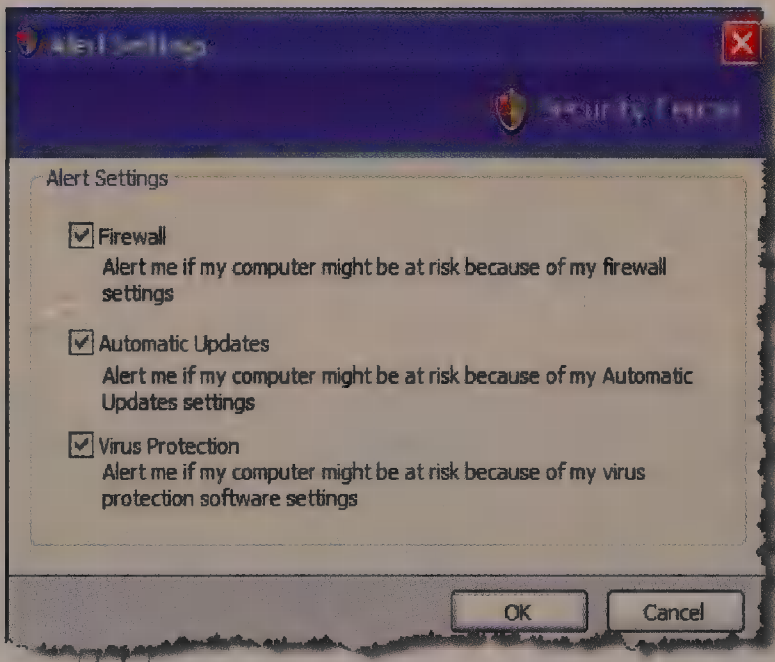
That screen will also give you options on how to install them. Click on **Express** and Windows will do the installation straightaway. If you click on **Custom Install**, you'll get a list with the name of each update and what it's designed to do plus the further option of either installing each one or skipping the installation.

You can adjust future settings by going to **Start**, **Control Panel**, **Security Center** (see screenshot below).

If you click on **Change the way Security Center alerts me**…



…you'll get this choice:



EXCEL CAN PRINT AN ENTIRE FILE EVEN WITH A MIX OF WORKSHEET ORIENTATIONS

Q Some of the worksheets in my Excel files are in landscape orientation and some are portrait. To maintain the orientations when I print the entire file, I print each worksheet separately, which is time-consuming. Is there some way to do the task in one print order?

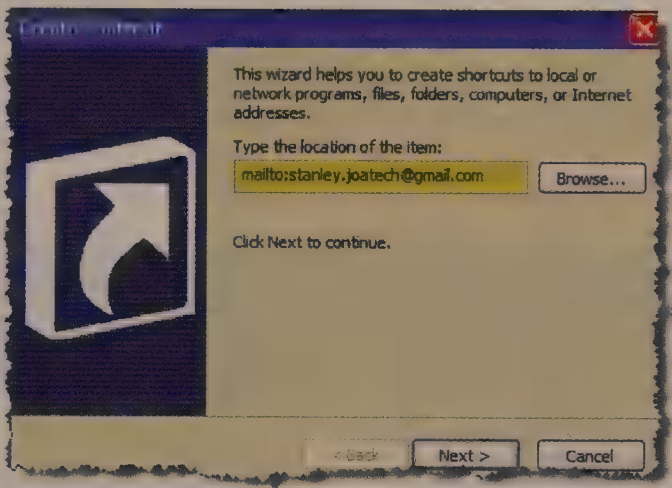
A Obviously you never tried to print the mixed-oriented file in one shot. If you had, you would have discovered that Excel anticipated your problem: It keeps track of the orientation and prints each worksheet correctly. This works in both Excel 2003 and 2007.

Don't feel bad about the oversight: Consider the experience a gentle nudge to encourage you to further explore the abilities of your software. You may waste a few sheets of paper now and then, but it's a small investment for what you may learn.

A FAST WAY TO LAUNCH AN E-MAIL

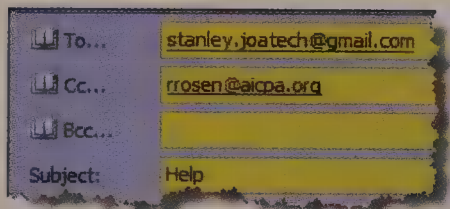
Q There are a handful of people I communicate with by e-mail a half-dozen times a day. Each time I want to send them a note I have to set up a new e-mail and either click for their address or type it in. There has to be a better, faster way.

A There is, and it's just as easy to set up. On any blank space on your desktop, right-click and click on **New**, **Shortcut**, which produces the **Create Shortcut** screen. If I'm going to be the recipient of all those e-mails, type mailto:stanley.joatech@gmail.com (see screenshot below).

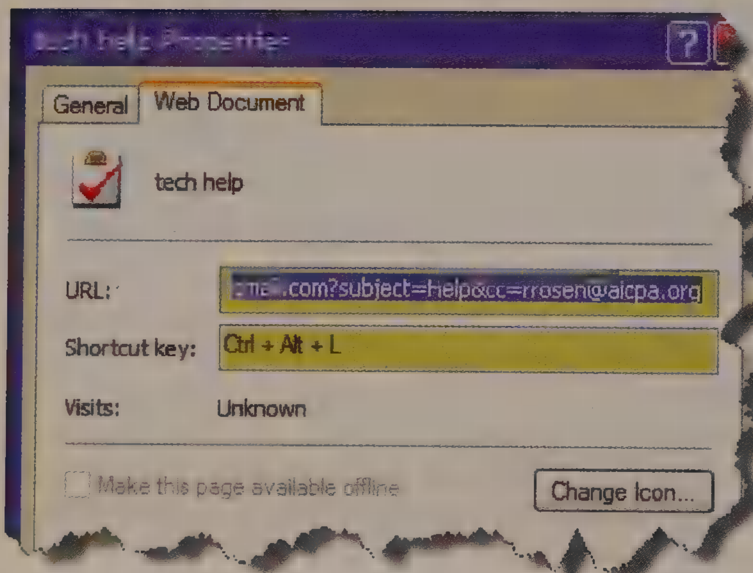


If you want the e-mail to include a subject line and a cc address, just add a ? and an & like this:
mailto:stanley.joatech@gmail.com?subject=Help%&cc=rrosen@aicpa.org

And here is what the Outlook address line looks like:



You may also want to customize the icon for the shortcut by clicking on **Properties**. And if you really want to get techie, you can create a shortcut key (see screenshots at right and below).



ENGAGE THE OPTION: CLICK INSIDE A WORD TO SELECT THE ENTIRE WORD

Q When I used Word 2003, I could italicize a whole word by putting the cursor anywhere in the word and then pressing Ctrl+I. But when I do that in Word 2007, nothing happens. What's up?

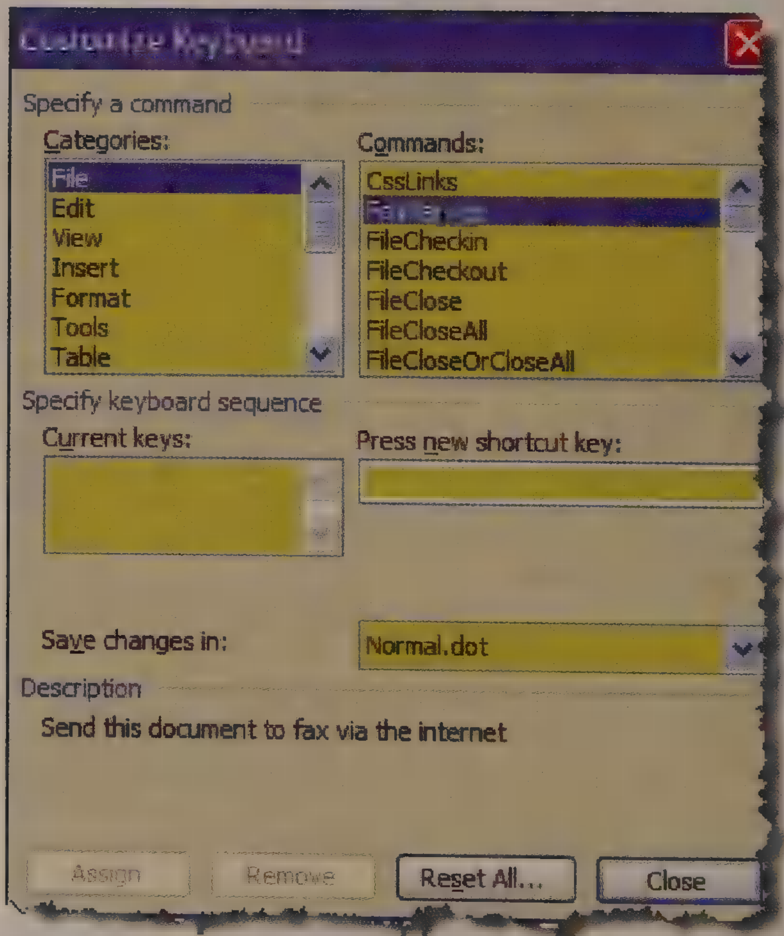
A Word 2007 can do it, but you have to tell it to. Here's how: Click on **Button** and **Word Options**. Then click on **Advanced** and place a check next to **When selecting, automatically select entire word**.

You may not realize it, but Word 2003 has the same limitation: It won't format the entire word unless you tell it. If it's not working for you, fix it by going to **Tools**, **Options…**, **Edit** and placing a check next to **When selecting, automatically select entire word**.

Tip: If you want to automatically select the entire sentence, place your mouse icon anywhere in the sentence, hold down the Ctrl key and left-click.

INVENTORY YOUR KEYBOARD SHORTCUTS AND CLEAR OUT THE USELESS ONES

Q Help! Something happened to my shortcut keys in Word. They got all botched up. I know how to reset them, so that's not my question. But what I discovered when I started to reset them was that I have way more shortcuts than I thought I had—and for tasks I never used and never will use. It'll take me hours of searching to uncover all of them, and I believe I must do that because I'm afraid if I don't clean up the mess, I may later inno-



cently create shortcuts that could short-circuit the shortcuts that I want and need. What can I do?

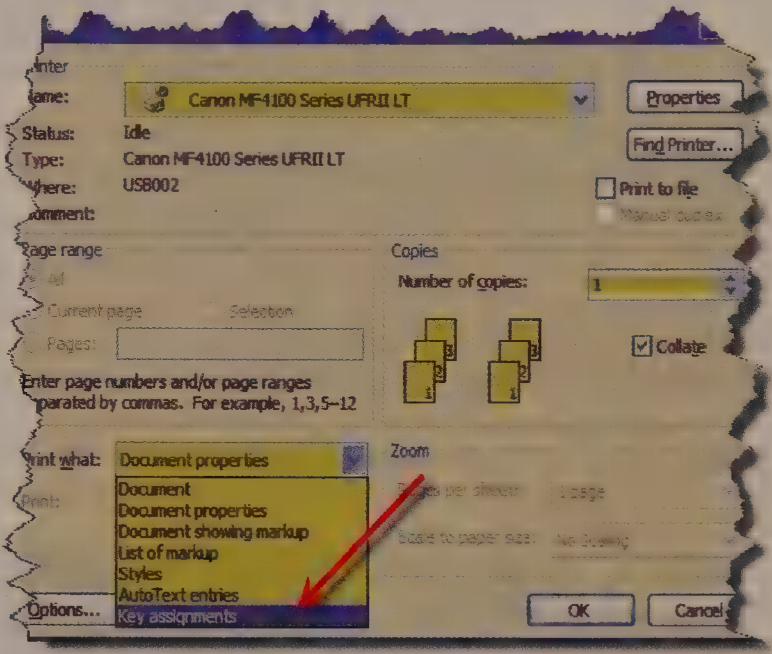
A Relax. Multiple shortcut keys present no danger to your system. Both sets of keys simply will be able to trigger the shortcut without a problem. But if all those shortcuts really bother you, you can reset the entire system and just add the shortcuts you want.

To do that in Word, click on **Tools**, **Customize...** and then on **Keyboard...** at the bottom of the screen to evoke the **Customize Keyboard** screen (see screenshot on previous page).

Clicking on **Reset All** will clear your custom keyboard shortcuts. Now you can enter whatever shortcuts you wish. When you're done, I'd suggest you do a printout of them so you can have a handy record whenever you need it. To get a printout of everything you added, click on **File**, **Print** and under **Print what**, scroll down to **Key assignments** and click on **OK** (see screenshot below). ❖

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to me via e-mail at stanley.joatech@gmail.com or via regular mail at the *Journal of Accountancy*, 220 Leigh Farm Road, Durham, NC 27707-8110.

Because of the volume of mail, I regret I cannot individually answer submitted questions. However, if a reader's question has broad interest, I will answer it in a forthcoming Technology Q&A column.



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Inside AICPA

Volunteer receives PFP award…Birnberg honored with AAA/AICPA Lifetime Contribution Award… PCFRC names two new committee members…Management accounting research recognized with award…AICPA seeks opinions on financial reporting model… AICPA offers Job Finder site...Where to Turn

DIAMOND RECEIVES PERSONAL FINANCIAL PLANNING AWARD

Irvin F. Diamond, CPA/PFS, of Albuquerque, N.M., received the AICPA's 2008 Personal Financial Planning Distinguished Service Award.

Irvin F. Diamond

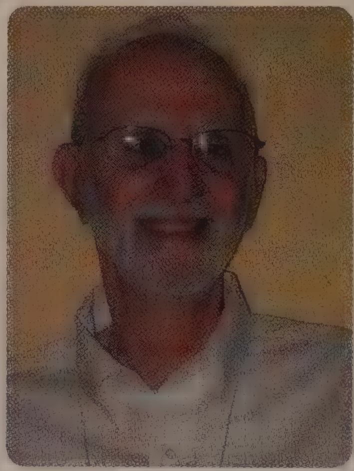
Presented at the 2009 Advanced Personal Financial Planning Conference in San Diego, the award is given to an AICPA volunteer who significantly contributes to the advancement of personal financial planning as a practice discipline and exemplifies the CPA as financial planner.

Diamond is a senior principal of REDW Business and Financial Resources LLC, based in Albuquerque. He is also a founding member of the National CPA Financial Literacy Commission, the leadership body for the profession's financial literacy efforts, which include 360 Degrees of Financial Literacy, designed to help Americans improve their financial understanding, and Feed the Pig, a public service advertising campaign to encourage saving among 25- to 34-year-olds.

Diamond served as vice president and member of the Institute's board of directors and is a past president of the New Mexico Society of CPAs. He received a "Highest Distinction" designation for his grade on the AICPA Personal Financial Specialist exam and has been recognized as one of the nation's top financial and tax advisers by several magazines, including *Worth* and *Money*.

RETIRED PROFESSOR AND RESEARCHER HONORED FOR LIFETIME CONTRIBUTION TO MANAGEMENT ACCOUNTING

Jacob G. Birnberg, Ph.D., was awarded the 2008 Lifetime Contribution Award from the Management Accounting Section of the American Accounting Association.



Jacob G. Birnberg

The award, sponsored by the AICPA, recognizes individuals who have made an important mark on management accounting, education, research and practice.

Birnberg was honored for his research and teachings regarding the application of behavioral sciences to accounting problems from organizational, individual and group perspectives. His work has been published in both accounting and nonaccounting journals such as *Policy Sciences*, *American Journal of Community Psychology* and *Human Resources*. He also collaborated on the landmark text, *Cost Accounting: Accounting Data for Management Decisions*, which was published in 1968.

In 1999, Birnberg received the Lifetime Scholarly Contribution Award from the Accounting, Behavior and Organizations Section of the AAA.

He retired as the Robert W. Murphy Jr. Professor of Management Control Systems Emeritus at the Joseph M. Katz Graduate School of Business at the University of Pittsburgh in 2006, where he began teaching in 1964. From 1960 to 1964, Birnberg served on the faculty of the University of Chicago's Graduate School of Business.

BURZENSKI, SHELTON JOIN PCFRC

John R. Burzenski

John R. Burzenski, president and managing officer of Burzenski & Co. PC, in East Haven, Conn., and Steven A. Shelton, president and managing partner at Way, Ray, Shelton and Co. PC, in Tuscaloosa, Ala., were named to the Private Company Financial Reporting Committee.

The PCFRC is a FASB committee that receives administrative support from the AICPA and is part of a joint standard-setting improvement effort by FASB and the AICPA.

Burzenski and Shelton replace Carl Bagge and Carisa Wisniewski, whose two-year terms ended.

Burzenski works with business owners to compile financial information, to review operations and compare them to industry standards, to assess industry-specific software, to consult about business transition and to prepare business plans. He served as chair of the AICPA Peer Review Board and the Connecticut Society of CPAs' Peer Review Committee. He also co-authored *Reference Book for Bankers and Other Credit Grantors of Financial Statements*, a CSCPA publication.


Steven A. Shelton

Shelton's practice focuses on private for-profit companies, with an emphasis on audits, reviews and compilations of financial statements, mergers and acquisitions and corporate equity and financing. He served as president, vice president and secretary-treasurer of the Tuscaloosa Chapter of the Alabama Society of CPAs and INPACT Americas, a nonprofit association of 35 North American accounting firms focused on the profitability and growth of its member firms.

RESEARCHERS WIN AWARD IN MANAGEMENT ACCOUNTING

Janek Ratnatunga, Norman Gray and Bala K.R. (Kashi) Balachandran are the winners of the first Greatest Potential Impact on Practice Award for research in management accounting, an award given by the American Accounting Association's Management Accounting Section and sponsored by the AICPA, the Chartered Institute of Management Accountants and the Society of Management Accountants of Canada.

The award, which recognizes academic papers considered to be most likely to have a significant impact on management accounting practice, was presented in January at the AAA MAS Midyear Meeting in Florida.

Their paper, "The Capability Economic Value of Intangible and Tangible Assets (CEVITA): The Valuation and Reporting of Strategic Capabilities," was originally published in *Management Accounting Research*, CIMA's research journal, and introduces a new technique for measuring and reporting the impact of tangible and intangible asset combinations on the value creation potential, or strategic capability of a business.

Ratnatunga is the head of the School of Commerce at the University of South Australia. He has also held academic positions at the University of Melbourne, Monash University and the University of Canberra in Australia and the universities of Washington, Richmond and Rhode Island in the United States. Previously, he practiced as a chartered accountant with KPMG.

Now retired, Gray previously was the head of the Airborne Early Warning and Control Division of the Defence Materiel Organization within the Department of Defence in Australia.

Balachandran is a professor of accounting and operations management at New York University Stern School of Business. He received his bachelor of engineering in mechanical engineering from the University of Madras, India, and attended the University of California, Berkeley, for his master of science in industrial engineering and Ph.D. in operations research.

INSTITUTE SEEKS VOLUNTEERS TO PROVIDE FEEDBACK ON REVENUE RECOGNITION MODEL

The AICPA is looking for volunteers to provide feedback on the new revenue recognition model proposed by FASB and the IASB.

The boards have developed a single, contract-based revenue recognition model to improve financial reporting by providing clearer guidance on when an entity should recognize revenue and by reducing the number of standards to which entities must refer. It is expected that adoption in its current form would affect:

- Companies that recognize revenue from construction or long-term contracts
- Agricultural activities
- Software sales
- Multiple-element arrangements

The changes would also affect contract origination costs, sales incentives and post-delivery services.

Volunteers' feedback will be included in an AICPA response letter on how the proposed model will affect U.S. companies.

If you have prepared financial statements under current GAAP and would like to participate, please submit your name to AICPA Volunteer Services at volunteerservices@aicpa.org or contact Kim Kushmerick at kkushmerick@aicpa.org.

INSTITUTE'S JOB FINDER HELPS CPAs AFFECTED BY ECONOMIC DOWNTURN

The AICPA is providing a free online job finder to help accounting employers and employees find opportunities during the current recession.

The CPA Job Finder is located at **www.cpajobfinder.com**, and listings are free to AICPA members and firms. ❖

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Exposure Drafts Outstanding

(This list was compiled as of Feb. 13, 2009. More current information may be available in *The CPA Letter* or at **www.aicpa.org**. *Note:* The policy for updating the list of exposure drafts is that a document should remain on the list until a final document has been issued or the project has been dropped. However, no comments will be received after the comments deadline has expired. The list is not all-inclusive but is intended to present the exposure drafts of particular interest to professional accountants.)

Issue Date	Title or Description	Comment Deadline
FASB		
10/9/08	Subsequent Events	12/8/08
10/9/08	Going Concern	12/8/08
9/15/08	Accounting for Transfers of Financial Assets (an amendment of FASB Statement No. 140)	11/14/08
9/15/08	Amendments to FASB Interpretation No. 46(R)	11/14/08
8/7/08	Earnings per Share—an amendment of FASB Statement No. 128 (Revision of Exposure Draft Issued September 30, 2005)	12/5/08
6/6/08	Accounting for Hedging Activities (an amendment of FASB Statement No. 133)	8/15/08
6/5/08	Disclosure of Certain Loss Contingencies (an amendment of FASB Statements No. 5 and 141(R))	8/8/08
5/29/08	Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information	9/29/08
10/9/06	Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition (an amendment of FASB Statement No. 142)	1/29/07
10/9/06	Not-for-Profit Organizations: Mergers and Acquisitions	1/29/07
AcSEC (AICPA)		
9/10/08	Proposed Audit and Accounting Guide, Gaming	12/9/08
ASB (AICPA)		
2/9/09	**Proposed Statement on Auditing Standards, Initial Audit Engagements, Including Reaudits—Opening Balances**	**5/29/09**
1/30/09	**Proposed Statement on Auditing Standards, Consideration of Laws and Regulations in an Audit of Financial Statements**	**5/29/09**
1/30/09	**Proposed Statement on Auditing Standards, Risk Assessment Standards (Redrafted)**	**4/30/09**
1/28/09	**Proposed Statement on Auditing Standards, Consideration of Fraud in a Financial Statement Audit (Redrafted)**	**5/29/09**
1/21/09	**Proposed Statements on Auditing Standards, Required Supplementary Information, Other Information in Documents Containing Audited Financial Statements and Other Information in Relation to the Financial Statements as a Whole**	**5/15/09**
12/24/08	Proposed Statement on Auditing Standards, Compliance Audits	4/30/09
11/17/08	Proposed Statement on Standards for Attestation Engagements, Reporting on Controls at a Service Organization	2/17/09
11/17/08	Proposed Statement on Auditing Standards, Audit Considerations Relating to an Entity Using a Service Organization (Redrafted)	2/17/09
9/26/08	Proposed Preface to Codification of Statements on Auditing Standards, Principles Governing an Audit Conducted in Accordance With Generally Accepted Auditing Standards, and Proposed Statement on Auditing Standards, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards	12/30/08
5/9/05	Proposed Statement on Auditing Standards: Amendment to Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles, for Nongovernmental Entities	6/27/05
OTHER (AICPA)		
2/23/09	**Trust Services Principles, Criteria, and Illustrations**	**4/8/09**
11/26/08	Proposed Statements on Standards for Tax Services	5/15/09
3/7/01	Statement on Standards for Continuing Professional Education Programs	8/1/01
SEC		
6/26/02	Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process; Release Nos. 33-8109; 34-46120; 35-27543; IA-2039; IC-25624	9/3/02
5/10/02	Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (Release Nos. 33-8098; 34-45907)	7/19/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 33-8090	6/24/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 34-45742	6/24/02
2/18/00	SEC Concept Release: International Accounting Standards	5/23/00
1/21/00	Supplementary Financial Information	4/17/00
GASB		
8/28/08	Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards	10/30/08
8/28/08	The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments	10/30/08
7/31/08	Suggested Guidelines for Voluntary Reporting of SEA Performance Information	10/31/08
IFAC		
9/30/08	Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities	3/31/09

New additions appear in bold, blue type.

Issue Date	Title or Description	Comment Deadline
9/29/08	Matters to Consider in a Revision of International Standard on Review Engagements (ISRE) 2400, Engagements to Review Financial Statements	12/15/08
9/3/08	IPSAS 5 "Borrowing Costs" (Revised 200X)	1/7/09
7/15/08	Code of Ethics for Professional Accountants	10/15/08
6/23/08	Costing to Drive Organizational Performance	9/12/08
6/23/08	Evaluating and Improving Governance in Organizations	9/12/08
3/10/08	Accounting and Financial Reporting for Service Concession Arrangements	8/1/08
3/6/08	Social Benefits: Disclosure of Cash Transfers to Individuals or Households	7/15/08
12/21/07	Proposed New International Standard on Assurance Engagements ISAE 3402, Assurance Reports on Controls at a Third Party Service Organization	5/31/08
12/21/07	Proposed New International Standard on Auditing ISA 265, Communicating Deficiencies in Internal Control	4/30/08
8/3/07	Proposed Redrafted International Standard on Auditing ISA 700 (Redrafted), The Independent Auditor's Report on General Purpose Financial Statements	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 800 (Revised and Redrafted), Special Consideration—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 805 (Revised and Redrafted), Engagements to Report on Summary Financial Statements	11/30/07
12/29/06	Proposed Revised Section 290 of the Code of Ethics for Professional Accountants, Independence—Audit and Review Engagements, and Proposed Section 291, Independence—Other Assurance Engagements	4/30/07

Issue Date	Title or Description	Comment Deadline
FASAB		
12/2/08	The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board.	2/2/09
11/18/08	Draft Staff Implementation Guidance: Fiduciary Q&As	12/3/08
11/17/08	Accounting for Social Insurance, Revised	2/9/09
11/14/08	Estimating the Historical Cost of General Property, Plant, and Equipment—Amending Statements of Federal Financial Accounting Standards 6 and 23	1/30/09
9/2/08	Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government	1/5/09
5/21/07	Accounting for Federal Oil and Gas Resources	1/11/08
PCAOB		
2/26/08	Proposed Auditing Standard—Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Control Standards	5/12/08
10/17/07	An Audit of Internal Control That Is Integrated With an Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies	12/17/07
5/24/07	Amendments to Limit Board Rule 4003's Fixed Periodic Inspection Requirement to Firms That Regularly Issue Audit Reports	7/23/07
4/3/07	Proposed Auditing Standard—Evaluating Consistency of Financial Statements and Proposed Amendments to Interim Auditing Standards	5/18/07
12/19/06	Amendments to Board Rules Relating to Inspections	2/16/07
5/23/06	Proposed Rules on Succeeding to the Registration Status of a Predecessor Firm	7/24/06
5/23/06	Proposed Rules on Periodic Reporting by Registered Public Accounting Firms	7/24/06
10/26/04	Proposed Rule on Procedures Relating to Subpoena Requests in Disciplinary Proceedings	11/29/04

INFORMATION

The initials stand for the following organizations. Exposure drafts are available online at the Web addresses below or copies may be obtained at the address in parentheses (unless otherwise indicated).

FASB– Financial Accounting Standards Board (Order Department, Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); **www.fasb.org**

GASB– Governmental Accounting Standards Board (Order Department, Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); **www.gasb.org**

AICPA– American Institute of CPAs (American Institute of Certified Public Accountants, 220 Leigh Farm Road, Durham, NC 27707-8110). AICPA publishes exposure drafts exclusively on the Web at **www.aicpa.org**. Print copies are not available.

IASB– International Accounting Standards Board (International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom); **www.iasb.org**

IFAC– International Federation of Accountants (International Federation of Accountants, 545 Fifth Avenue, 14th Floor, New York, NY 10017); **www.ifac.org**

SEC– Securities and Exchange Commission (Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549); **www.sec.gov**

FASAB– Federal Accounting Standards Advisory Board (Federal Accounting Standards Advisory Board, 441 G Street, N.W., Suite 6814, Washington, DC 20548); **www.fasab.gov**

PCAOB– Public Company Accounting Oversight Board (Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, DC 20006-2803); **www.pcaobus.org**

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The Technical Information Service answers inquiries about specific audit or accounting problems. Call toll-free **877-242-7212** or e-mail query to aahotline@aicpa.org. **This service is free to AICPA members.**

OFFICIAL RELEASES

SAS 116...SSARS 18

SAS 116

Statement on Auditing Standards No. 116, *Interim Financial Information*

Amendment to AU Section 722, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1)

1. The purpose of this amendment is to revise AU section 722 to establish standards and provide guidance on the independent accountant's professional responsibilities when the accountant undertakes an engagement to review interim financial information of a nonissuer[*], including companies offering securities pursuant to Securities and Exchange Commission (SEC) Rule 144A or participating in private equity exchanges, when the conditions in paragraph .05 of this section are met. This amendment removes the guidance for reviews of the interim financial statements of issuers since such guidance appropriately resides in the auditing standards of the Public Company Accounting Oversight Board. New language is shown in boldface italics; deleted language is shown by strikethrough.

INTRODUCTION

.01 The purpose of this section is to establish standards and provide guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of *interim financial information* (as that term is defined in paragraph .02 of this section) ***when the conditions in paragraph .05 are met.*** The three general standards discussed in section 150, *Generally Accepted Auditing Standards*, paragraph .02, are applicable to a review of interim financial information conducted in accordance with this section. This section provides guidance on the application of the field work and reporting standards to a review of interim financial information, to the extent those standards are relevant.

* An *issuer* is defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c], the securities of which are registered under section 12 of that act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn. A *nonissuer* is any entity except for one defined as an issuer.

.02 For purposes of this section, the term *interim financial information* means financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end. ***Interim financial information may be condensed or in the form of a complete set of financial statements. Additionally, the term*** **applicable financial reporting framework** ***means a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, accounting principles generally accepted in the United States of America (also known as U.S. GAAP), International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), or comprehensive bases of accounting other than GAAP.***

.03 ***An entity may be required or otherwise desire to engage an independent accountant to perform a review of the entity's interim financial information.*** ~~The Securities and Exchange Commission (SEC) requires~~[1] ~~a registrant to engage an independent accountant to review the registrant's interim financial information, in accordance with this section, before the registrant files its quarterly report on Form 10-Q or Form 10-QSB.~~ Although this section ***generally*** does not require an accountant to issue a written report on a review of interim financial information, ~~the SEC requires that~~ an accountant's review report ***should accompany*** ~~be filed with~~ the interim financial information if, in ~~any filing,~~ ***a report; document; or written communication containing the reviewed interim financial information,*** the entity states that the interim financial information has been reviewed by an independent public accountant ***or makes other reference to the accountant's association. In other situations, the accountant may determine it appropriate to issue a written report to address the risk that a user of interim financial information may associate the accountant with the interim financial information and, in the absence of a review report, inappropriately assume a higher level of assurance than that obtained.*** Paragraphs .37–.46 of this section provide reporting guidance for a review of interim financial information.

.04 Section 315, *Communications Between Predecessor and Successor Auditors*, requires a successor auditor to contact the entity's predecessor auditor and make inquiries of the predecessor auditor in deciding whether to accept appointment as an entity's independent auditor. Such inquiries should be completed before accepting an engagement to perform an initial review of an entity's interim financial information.

[1]. ~~The Securities and Exchange Commission (SEC) requirement is set forth in Rule 10-01(d) of Regulation S-X for Form 10-Q and item 210(b) of Regulation S-B for Form 10-QSB.~~

APPLICABILITY[2]

.05 An accountant may conduct, in accordance with this section, a review of ~~the~~ interim financial information ~~of an SEC registrant~~[3] ~~or of a non-SEC registrant that makes a filing with a regulatory agency~~[4] ~~in preparation for a public offering or listing,~~ if

a. the entity's latest annual financial statements have been ~~or are being~~ audited ***by the accountant or a predecessor;*** ~~. The interim financial information may be presented in the form of financial statements or in a summarized form that purports to conform with generally accepted accounting principles.~~
b. ***the accountant has been engaged to audit the entity's current year financial statements, or the accountant audited the entity's latest annual financial statements and expects to be engaged to audit the current year financial statements;***
c. ***the client prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements; and***
d. ***if the interim financial information is condensed information, all of the following conditions are met:***
   i. ***The condensed interim financial information purports to conform with an appropriate financial reporting framework, which includes appropriate form and content of interim financial statements; for example, Accounting Principles Board (APB) Opinion No. 28,*** **Interim Financial Reporting,** ***and Article 10 of SEC Regulation S-X with respect to accounting principles generally***

2 Statements on Standards for Accounting and Review Services provide guidance for review engagements for which this section is not applicable.

[3]. ~~This section also is applicable to a review of the interim financial information of a subsidiary, corporate joint venture, or investee of an SEC registrant, when that review is performed in the context of the review of the interim financial information of the SEC registrant itself.~~

[4]. ~~For purposes of this section, a *regulatory agency* is the SEC and the following agencies with which an entity files periodic reports pursuant to the Securities Exchange Act of 1934: Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve System, and Office of Thrift Supervision.~~

(continued on page 84)

accepted in the United States of America[5] *or International Accounting Standard 34,* Interim Financial Reporting, *with respect to IFRS issued by the IASB may be appropriate financial reporting frameworks for interim financial information.*~~and applicable regulatory requirements, for example, Article 10 of Regulation S-X for Form 10-Q.~~

ii. The condensed interim financial information includes a note that the financial information does not represent complete financial statements and should be read in conjunction with the entity's latest annual audited financial statements.

iii. The condensed interim financial information accompanies the entity's latest audited annual financial statements or such audited annual financial statements are made readily available by the entity. The financial statements are deemed to be readily available if a third party user can obtain the financial statements without any further action by the entity (for example, financial statements on an entity's Web site may be considered readily available, but being available upon request is not considered readily available).

[.06] ~~Many SEC registrants are required by item 302(a) of Regulation S-K to include selected quarterly financial data (that is, interim financial information for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included) in their annual reports and in certain other SEC filings. Consequently, a review of the entity's fourth quarter interim financial information must be conducted even though a quarterly report for the fourth quarter is not filed on Form 10-Q. Furthermore, an accountant performing an initial audit of an entity's annual financial statements that includes selected quarterly data who has not previously reviewed one or more of the quarters in that year should perform a review of those quarters, in accordance with this section, in order to report on the audited financial statements containing such interim financial information.~~

Objective of a Review of Interim Financial Information

.07 The objective of a review of interim financial information pursuant to this section is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ *the applicable financial reporting framework*. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with generally accepted auditing standards. A review of interim financial information does not provide a basis for expressing an opinion about whether the ***interim*** financial ~~statements are~~ ***information is*** presented fairly, in all material respects, in conformity with ~~generally accepted accounting principles~~ *the applicable financial reporting framework*. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (*a*) tests of accounting records through inspection, observation, or confirmation; (*b*) tests of controls to evaluate their effectiveness; (*c*) ***the obtainment of*** ~~obtaining~~ corroborating evidence in response to inquiries; or (*d*) ***the performance of*** ~~performing~~ certain other procedures ordinarily performed in an audit. A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit. Paragraph .22 of this section provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with ~~generally accepted accounting principles~~ *the applicable financial reporting framework*.

Establishing an Understanding With the Client

.08 The accountant should establish an understanding with the client regarding the services to be performed in an engagement to review interim financial information~~.~~[6] ***and should document the understanding through a written communication with the client.*** Such an understanding reduces the risk that either the accountant or the client may misinterpret the needs or expectations of the other party. ~~This~~ ***The*** understanding should include the objectives of the engagement, ***the limitations of the engagement,*** management's responsibilities, ***and*** the accountant's responsibilities~~, and the limitations of the engagement~~. ***The understanding should also include the expected form of the communication upon completion of the engagement (that is, whether as a written or oral report).*** ~~The accountant should document this understanding, preferably through a written communication with the client. If the accountant believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.~~ ***Additionally, prior to accepting the engagement, the accountant should, through inquiry and, if applicable, information obtained during the course of the previous or current annual audit or during other engagements, assess management's ability to acknowledge their responsibility to establish and maintain controls that are sufficient to provide a reasonable basis for the preparation of reliable interim financial information in accordance with the applicable financial reporting framework. If management does not have the ability to make such an acknowledgement of its responsibility, the independent accountant should not accept the engagement.***

.09 An understanding with the client regarding a review of interim financial information generally includes the following matters.

Objectives of the engagement

- The objective of a review of interim financial information is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with ~~accounting principles generally accepted in the United States of America~~ *the applicable financial reporting framework*.[7]
- ***A review includes obtaining sufficient knowledge of the entity's business and its internal control as it relates to the preparation of both annual and interim financial information to***
  - ***identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.***
  - ***select the inquiries and analytical procedures that will provide the accountant with a basis for communicating whether the accountant is aware of any material modifications that should be made to the interim financial information for it to conform with the applicable financial reporting framework.***

Limitations of the engagement

- ***A review does not provide a basis for expressing an opinion about whether the financial information is presented fairly, in all material respects, in conformity with the applicable financial reporting framework.***
- ***A review does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit.***
- ***A review is not designed to provide assurance on internal control or to identify significant deficiencies and material weaknesses in internal control; however, the accountant is responsible for communicating to management and those charged with governance any significant deficiencies or material weaknesses in internal control that the accountant identified.***

5. Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, outlines the application of U.S. generally accepted accounting principles ***(GAAP)*** to the determination of income when interim financial information is presented, provides for the use of estimated effective income tax rates, and specifies certain disclosure requirements for summarized interim financial information issued by public companies. ***In addition to APB Opinion No. 28, other statements issued by the Financial Accounting Standards Board also include disclosure requirements for interim financial information.*** ~~Footnote 3 of section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, paragraph .10, indicates that, for SEC registrants, rules and interpretive releases of the SEC have an authority similar to that of category "a" accounting principles.~~

6. See paragraph .28 of QC section 10, *A Firm's System of Quality Control.*

7. *Paragraph .05 of this section addresses the selection of the applicable financial reporting framework for interim financial information.*

Management's responsibilities

- Management is responsible for
  - — ~~Management is responsible for the~~ ***the*** entity's interim financial information.
  - — ~~Management is responsible for establishing~~ ***establishing*** and maintaining effective internal control over financial reporting.
  - — ~~Management is responsible for identifying~~ ***identifying*** and ensuring that the entity complies with the laws and regulations applicable to its activities.
  - — ~~Management is responsible for making~~ ***making*** all financial records and related information available to the accountant.
  - — ~~At the conclusion of the engagement, management will provide~~ ***providing*** the accountant, ***at the conclusion of the engagement***, with a letter confirming certain representations made during the review.
  - — ~~Management is responsible for adjusting~~ ***adjusting*** the interim financial information to correct material misstatements. Although a review of interim financial information is not designed to obtain reasonable assurance that the interim financial information is free from material misstatement, management also is responsible for affirming in its representation letter to the accountant that the effects of any uncorrected misstatements aggregated by the accountant during the current engagement and pertaining to the current-year period(s) under review are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole.

The accountant's responsibilities

- The accountant is responsible for conducting the review in accordance with standards established by the AICPA. A review of interim financial information consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with ~~generally accepted auditing standards~~ ***auditing standards generally accepted in the United States of America***, the objective of which is the expression of an opinion regarding the financial ***information*** ~~statements~~ taken as a whole. Accordingly, the accountant will not express an opinion on the interim financial information.

Expected form of the communication

- ***A description of the expected form of the accountant's communication upon completion of the engagement, (that is, whether as a written or oral report) and a statement that if the entity states in any report, document, or written communication containing the interim financial information that the information has been reviewed by the accountant or makes other reference to the accountant's association, that the accountant's review report will be included in the document.***
- ~~A review includes obtaining sufficient knowledge of the entity's business and its internal control as it relates to the preparation of both annual and interim financial information to:~~
  - — ~~Identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.~~
  - — ~~Select the inquiries and analytical procedures that will provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.~~
- ~~A review is not designed to provide assurance on internal control or to identify significant deficiencies and material weaknesses in internal control. However, the accountant is responsible for communicating to management and those charged with governance any significant deficiencies or material weaknesses in internal control that come to his or her attention.~~

The Accountant's Knowledge of the Entity's Business and Its Internal Control

.10 To perform a review of interim financial information, the accountant should have sufficient knowledge of the entity's business and its internal control[8] as they relate to the preparation of both annual and interim financial information to

- ***identify*** the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.
- ***select*** the inquiries and analytical procedures that will provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.

.11 In planning a review of interim financial information, the accountant should perform procedures to update his or her knowledge of the entity's business and its internal control to (*a*) aid in the determination of the inquiries to be made and the analytical procedures to be performed and (*b*) identify particular events, transactions, or assertions to which the inquiries may be directed or analytical procedures applied. Such procedures should include

- reading documentation of the preceding year's audit and of reviews of prior interim period(s) of the current year and corresponding ~~quarterly and year-to-date~~ interim period(s) of the prior year to the extent necessary, based on the accountant's judgment, to enable the accountant to identify matters that may affect the current-period interim financial information. In reading such documents, the accountant should specifically consider the nature of any (*a*) corrected material misstatements; (*b*) matters identified in any summary of uncorrected misstatements;[~~7~~9] (*c*) identified risks of material misstatement due to fraud, including the risk of management override of controls; and (*d*) significant financial accounting and reporting matters that may be of continuing significance, such as ~~weaknesses in internal control~~ ***significant deficiencies and material weaknesses***.
- reading the most recent annual and comparable prior interim period financial information.
- considering the results of any audit procedures performed with respect to the current year's financial statements.
- inquiring of management about changes in the entity's business activities.
- inquiring of management about whether significant changes in internal control, as it relates to the preparation of interim financial information, have occurred subsequent to the preceding annual audit or prior review of interim financial information, including changes in the entity's policies, procedures, and personnel, as well as the nature and extent of such changes.

.12 In an initial review of interim financial information, the accountant should perform procedures that will enable him or her to obtain sufficient knowledge of the entity's business and its internal control to address the objectives discussed in paragraph .07 of this section. As part of the procedures to obtain this knowledge, the accountant performing an initial review of interim financial information makes inquiries of the predecessor accountant and reviews the predecessor accountant's documentation for the preceding annual audit and for any prior interim periods in the current year that have been reviewed by the predecessor accountant if the predecessor accountant permits access to such documentation.[~~8~~10] In doing so, the accountant should specifically consider the nature of any (*a*) corrected material misstatements; (*b*) matters identified in any summary of uncorrected misstatements; (*c*) identified risks of

8. Paragraph .08 establishes a presumptively mandatory requirement that the accountant assess, through inquiry and, if applicable, information obtained during the course of the previous or current annual audit or during other engagements, management's ability to acknowledge their responsibility to establish and maintain controls that are sufficient to provide a reasonable basis for the preparation of reliable interim financial information in accordance with the applicable financial reporting framework as a precondition to performing a review under this section.

~~7~~*9*. Section 312, *Audit Risk and Materiality in Conducting an Audit*, paragraphs .69–.70, requires the auditor to document the nature and effect of misstatements that the auditor aggregates as well as the auditor's conclusion as to whether such misstatements, individually or in the aggregate, cause the audited financial statements to be materially misstated. Paragraphs .25–.26 of this section describe the accountant's consideration of such misstatements in a review of interim financial information.

~~8~~*10*. The accountant also may consider reviewing the predecessor accountant's documentation related to reviews of interim period(s) in the prior year.

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material misstatement due to fraud, including the risk of management override of controls; and (*d*) significant financial accounting and reporting matters that may be of continuing significance, such as ~~weaknesses in internal control~~ ***significant deficiencies or material weaknesses***. However, the inquiries made and analytical procedures performed or other procedures performed in the initial review and the conclusions reached are solely the responsibility of the successor accountant. If the successor accountant is reporting on the review, the successor accountant should not make reference to the report or work of the predecessor accountant as the basis, in part, for the successor accountant's own report. If the predecessor accountant does not respond to the successor accountant's inquiries, or does not allow the successor accountant to review the predecessor accountant's documentation, the successor accountant should use alternative procedures to obtain knowledge of the matters discussed in this paragraph.

.13 The accountant who has audited the entity's financial statements for one or more annual periods would have acquired sufficient knowledge of an entity's internal control as it relates to the preparation of annual financial information and may have acquired such knowledge with respect to interim financial information. If the accountant has not audited the most recent annual financial statements, the accountant should perform procedures to obtain such knowledge. Knowledge of an entity's internal control, as it relates to the preparation of both annual and interim financial information, includes knowledge of the relevant aspects of the control environment, the entity's risk assessment process, control activities, information and communication, and monitoring, as those terms are defined in section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. Internal control over the preparation of interim financial information may differ from internal control over the preparation of annual financial statements because certain accounting principles and practices used for interim financial information may differ from those used for the preparation of annual financial statements, for example, the use of estimated effective income tax rates for the preparation of interim financial information, which is prescribed by Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*.

.14 A restriction on the scope of the review may be imposed if the entity's internal control appears to contain deficiencies so significant that it would be impracticable for the accountant, based on his or her judgment, to effectively perform review procedures that would provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.[~~9~~11]

~~9~~ 11. See paragraph .28 of this section.

Analytical Procedures, Inquiries, and Other Review Procedures

.15 Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information to be reported. The accountant performs these procedures to obtain a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***. The specific inquiries made and the analytical and other procedures performed should be tailored to the engagement based on the accountant's knowledge of the entity's business and its internal control. The accountant's knowledge of an entity's business and its internal control influences the inquiries made and analytical procedures performed. For example, if the accountant becomes aware of a significant change in the entity's control activities at a particular location, the accountant may consider (*a*) making additional inquiries, such as whether management monitored the changes and considered whether they were operating as intended, (*b*) employing analytical procedures with a more precise expectation, or (*c*) both.

.16 *Analytical procedures and related inquiries*. The accountant should apply analytical procedures to the interim financial information to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Analytical procedures, for the purposes of this section, should include

- comparing the ~~quarterly~~ interim financial information with comparable information for the immediately preceding interim period, ***if applicable***, and ~~the quarterly and year-to-date interim financial information~~ with the corresponding period(s) in the previous year, giving consideration to knowledge about changes in the entity's business and specific transactions.
- considering plausible relationships among both financial and, where relevant, nonfinancial information. The accountant also may wish to consider information developed and used by the entity, for example, information in a director's information package or in a senior committee's briefing materials.
- comparing recorded amounts, or ratios developed from recorded amounts, to expectations developed by the accountant. The accountant develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates (see paragraph .17 of this section).
- comparing disaggregated revenue data, for example, comparing revenue reported by month and by product line or operating segment during the current interim period with that of comparable prior periods.

See appendix A [paragraph .54] of this section for examples of analytical procedures an accountant may consider performing when conducting a review of interim financial information. The accountant may find the guidance in section 329, *Analytical Procedures*, useful in conducting a review of interim financial information.

.17 Expectations developed by the accountant in performing analytical procedures in connection with a review of interim financial information ordinarily are less precise than those developed in an audit. Also, in a review the accountant ordinarily is not required to corroborate management's responses with other evidence. However, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business and its internal control.[~~10~~12]

.18 *Inquiries and other review procedures*. The following are inquiries the accountant should make and other review procedures the accountant should perform when conducting a review of interim financial information:

a. Reading the available minutes of meetings of stockholders, directors, and appropriate committees, and inquiring about matters dealt with at meetings for which minutes are not available, to identify matters that may affect the interim financial information.

b. Obtaining reports from other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity, its subsidiaries, or its other investees, or inquiring of those accountants if reports have not been issued.[~~11~~13]

c. Inquiring of members of management who have responsibility for financial and accounting matters concerning

i. whether the interim financial information has been prepared in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework*** consistently applied.

ii. unusual or complex situations that may have an effect on the interim financial information. (See appendix B [paragraph .55] of this section for examples of unusual or complex situations about which the accountant ordinarily would inquire of management.)

iii. significant transactions occurring or recognized in the last several days of the interim period.

iv. the status of uncorrected misstatements

~~10~~12. See paragraph .22 of this section.

~~11~~13. In these circumstances, the accountant ordinarily is in a position similar to that of an auditor who acts as principal auditor (see section 543, *Part of Audit Performed by Other Independent Auditors*) and makes use of the work or reports of other auditors in the course of an audit of financial statements.

identified during the previous audit and interim review (that is, whether adjustments had been recorded subsequent to the prior audit or interim period and, if so, the amounts recorded and period in which such adjustments were recorded).

v. matters about which questions have arisen in the course of applying the review procedures.

vi. events subsequent to the date of the interim financial information that could have a material effect on the presentation of such information.

vii. their knowledge of any fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others where the fraud could have a material effect on the financial ~~statements~~ ***information***.

viii. whether they are aware of allegations of fraud or suspected fraud affecting the entity, for example, received in communications from employees, former employees, analysts, regulators, short sellers, or others.

ix. significant journal entries and other adjustments.

x. communications from regulatory agencies.

xi. significant deficiencies and material weaknesses, in the design or operation of internal control~~s which could adversely affect the issuer's ability to record, process, summarize, and report financial data~~ ***as it relates to the preparation of both annual and interim financial information***.

d. Obtaining evidence that the interim financial information agrees or reconciles with the accounting records. For example, the accountant may compare the interim financial information to (1) the accounting records, such as the general ledger; (2) a consolidating schedule derived from the accounting records; or (3) other supporting data in the entity's records. In addition, the accountant should consider inquiring of management as to the reliability of the records to which the interim financial information was compared or reconciled.

e. Reading the interim financial information to consider whether, based on the results of the review procedures performed and other information that has come to the accountant's attention, the information to be reported conforms with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.

f. Reading other information ***in documents containing*** ~~that accompanies~~ the interim financial information ~~and is contained in reports[14] (1) to holders of securities or beneficial interests or (2) filed with regulatory authorities under the Securities Exchange Act of 1934 (such as Form 10-Q or 10-QSB),~~ to consider whether such information or the manner of its presentation is materially inconsistent with the interim financial information.[~~12~~15] If the accountant concludes that there is a material inconsistency, or becomes aware of information that he or she believes is a material misstatement of fact, the action taken will depend on his or her judgment in the particular circumstances. ~~In determining the appropriate course of action, the accountant should consider the guidance in section 550, *Other Information in Documents Containing Audited Financial Statements*, paragraphs .04–.06)~~.

.19 Many of the aforementioned review procedures can be performed before or simultaneously with the entity's preparation of the interim financial information. For example, it may be practicable to update the understanding of the entity's internal control and begin reading applicable minutes before the end of an interim period. Performing some of the review procedures earlier in the interim period also permits early identification and consideration of significant accounting matters affecting the interim financial information.

.20 *Inquiry concerning litigation, claims, and assessments.* A review of interim financial information does not contemplate obtaining corroborating evidence for responses to inquiries concerning litigation, claims, and assessments (see paragraph .07 of this section). Consequently, it ordinarily is not necessary to send an inquiry letter to an entity's lawyer concerning litigation, claims, and assessments. However, if information comes to the accountant's attention that leads him or her to question whether the interim financial information departs from ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***[~~13~~16] with respect to litigation, claims, or assessments, and the accountant believes the entity's lawyer may have information concerning that question, an inquiry of the lawyer concerning the specific question is appropriate.

.21 *Inquiry concerning an entity's ability to continue as a going concern.* A review of interim financial information is not designed to identify conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern. However, such conditions or events may have existed at the date of prior-period financial statements.[~~14~~17] In addition, in the course of performing review procedures on the current-period interim financial information, the accountant may become aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern. In either case, the accountant should (*a*) inquire of management as to its plans for dealing with the adverse effects of the conditions and events and (*b*) consider the adequacy of the disclosure about such matters in the interim financial information.[~~15~~18] It ordinarily is not necessary for the accountant to obtain evidence in support of the information that mitigates the effects of the conditions and events.

.22 *Extension of interim review procedures.* If, in performing a review of interim financial information, the accountant becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework*** in all material respects, the accountant should make additional inquiries or perform other procedures that the accountant considers appropriate to provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information. For example, if the accountant's interim review procedures lead him or her to question whether a significant sales transaction is recorded in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***, the accountant should perform additional procedures, such as discussing the terms of the transaction with senior marketing and accounting personnel, reading the sales contract, or both, to resolve his or her questions.

.23 *Coordination with the audit.* The accountant performing the review of interim financial information ordinarily will also be engaged to perform an audit of the annual financial statements of the entity. Certain auditing procedures ***associated with the annual audit*** may be performed concurrently with the review of interim financial information. For example, information gained from reading the minutes of meetings of the board of directors in connection with the review also may be used for the annual audit. Also, there may be significant or unusual transactions occurring during the interim period under review for which the auditing procedures that would need to be performed for purposes of the audit of the annual financial statements could be performed, to the extent practicable, at the

~~*14. The accountant may consider section 550,* Other Information in Documents Containing Audited Financial Statements, *which provides guidance for the auditor's consideration of other information included in such documents.*~~

~~12~~*15*. The principal accountant also may request other accountants involved in the engagement, if any, to read the other information.

~~13~~ *16*. ***For example, in*** ~~In~~ accordance with APB Opinion No. 28, **Interim Financial Reporting**, and Article 10 of Regulation S-X, contingencies and other uncertainties that could be expected to affect the fairness of the presentation of financial data at an interim date should be disclosed in interim ~~reports~~ ***financial information*** in the same manner required for annual ~~reports~~ ***financial statements***. Such disclosures should be repeated in interim ***financial information*** and annual ~~reports~~ ***financial statements*** until the contingencies have been removed, resolved, or become immaterial. The significance of a contingency or uncertainty should be judged in relation to annual financial statements.

~~14~~*17*. For purposes of this section, "conditions or events that existed at the date of prior-period financial statements" include (*a*) substantial doubt about the entity's ability to continue as a going concern that existed at the preceding year end, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (*b*) conditions and events disclosed in the immediately preceding interim period.

~~15~~*18*. Information that might be disclosed is set forth in section 341~~A~~, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, paragraph .10. If the accountant determines that the disclosure about the entity's possible inability to continue as a going concern is inadequate, a departure from generally accepted accounting principles exists.

(continued on page 90)

AICPA conferences

AICPA National Conference on Employee Benefit Plans

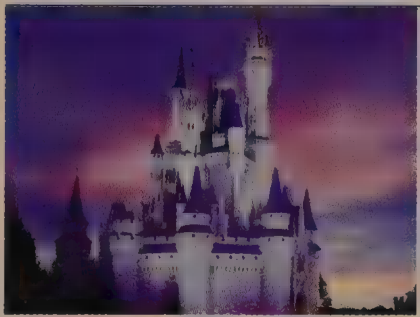
Rosen Shingle Creek
Orlando, FL
May 18-20, 2009

CPE Credits: up to 21(main) up to 12 (workshop)
Pre-Conference Workshops:
Sunday, May 17, 2009

CONFERENCE HIGHLIGHTS:

- Addresses both the tax and audit side of employee benefit plans
- Up-to-date regulatory information
- Practical guidance and tools
- Latest on the Employee Benefit Audit Quality Center

AICPA Emerging Partner Training Forum



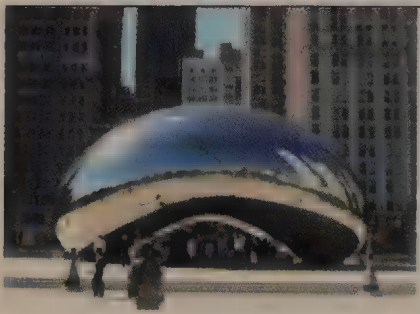
Disney Contemporary Resort
Lake Buena Vista (Orlando), FL
June 8-9, 2009

CPE Credits: 19 (main)

CONFERENCE HIGHLIGHTS:

- Growing Your Leadership Talent and Influence
- Firm Expectations of New and/or Emerging Partners
- Why B Students Make Great Partners
- Partner Compensation
- Understanding the Importance of Business Development, Selling and Marketing

AICPA Fair Value Measurements Conference



Hyatt Regency Chicago
Chicago, IL
June 8-9, 2009

CPE Credits: 16.5 (main) 4.5 (workshops)
Pre-Conference Workshops:
Sunday, June 7th, 2009

CONFERENCE HIGHLIGHTS:

- History and Evolution
- FAS 157
- Fair Value Best Practices Panel
- Valuating Alternative Investments
- Comparison of IFRS and IFRS for private entities to GAAP
- PEI, Private Equity Issues
- Auditing Fair Value Measurements

AICPA/Export Assist, Inc. Workshop on Export Tax Benefits

AICPA Office
Lewisville, TX
June 11-12, 2009

CPE Credits: 17.5

CONFERENCE HIGHLIGHTS:

- Overview of Export Tax Benefits and Exporter Profiles
- IC-DISC How It Works and Overview of Requirements
- Increasing IC-DISC Revenue
- Introduction to Export Exceptions and Exemptions
- Outbound Export Transactions, Offshore Funds Accumulation, Deferral and Foreign Tax Credits

time of the interim review, for example, business combinations, restructurings, or significant revenue transactions.

Written Representations From Management

.24 Written representations from management should be obtained for all interim financial information presented and for all periods covered by the review. Specific representations should relate to the following matters:[~~16~~19]

Interim *Financial* ~~Statements~~ Information

a. Management's acknowledgement of its responsibility for the fair presentation of the interim financial information in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.

b. Management's belief that the interim financial information has been prepared and presented in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework*** applicable to interim financial information.

Internal Control

c. *Management's acknowledgement of its responsibility to establish and maintain controls that are sufficient to provide a reasonable basis for the preparation of reliable interim financial information in accordance with the applicable financial reporting framework.*

~~c~~d. Disclosure of all significant deficiencies and material weaknesses, in the design or operation of internal control~~s which could adversely affect the issuer's ability to record, process, summarize, and report financial data~~ ***as it relates to the preparation of both annual and interim financial information***.

~~d~~e. Acknowledgment of management's responsibility for the design and implementation of programs and controls to prevent and detect fraud.

~~e~~f. Knowledge of fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others where the fraud could have a material effect on the ***interim*** financial ~~statements~~ ***information***.

~~f~~g. Knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, short sellers, or others.

Completeness of Information

~~g~~h. Availability of all financial records and related data.

~~h~~i. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors ***or summaries of actions of recent meetings for which minutes have not yet been prepared***.

~~i~~j. Communications with regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.

~~j~~k. Absence of unrecorded transactions.

Recognition, Measurement, and Disclosure

~~k~~l. Management's belief that the effects of any uncorrected financial statement misstatements aggregated by the accountant during the current review engagement and pertaining to the interim period(s) in the current year are immaterial, both individually and in the aggregate, to the interim financial information ~~taken~~ as a whole. (A summary of such items should be included in or attached to the letter.)[~~17~~20]

~~l~~m. Plans or intentions that may materially affect the carrying value or classification of assets or liabilities.

~~m~~n. Information concerning related-party transactions and amounts receivable from or payable to related parties.

~~n~~o. Guarantees, whether written or oral, under which the entity is contingently liable.

~~o~~p. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties* ***(AICPA, Technical Practice Aids, ACC sec. 10,640)***.

~~p~~q. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the interim financial information or as a basis for recording a loss contingency.

~~q~~r. Unasserted claims or assessments that are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

~~r~~s. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.

~~s~~t. Satisfactory title to all owned assets, liens or encumbrances on such assets, and assets pledged as collateral.

~~t~~u. Compliance with aspects of contractual agreements that may affect the interim financial information.

Subsequent Events

~~u~~v. Information concerning subsequent events.

The representation letter ordinarily should be tailored to include additional representations from management related to matters specific to the entity's business or industry. Appendix C [paragraph .56] of this section presents illustrative representation letters.

Evaluating the Results of Interim Review Procedures

.25 A review of interim financial information is not designed to obtain reasonable assurance that the interim financial information is free of material misstatement. However, based on the review procedures performed, the accountant may become aware of *likely misstatements*. In the context of an interim review, a likely misstatement is the accountant's best estimate of the total misstatement in the account balances or classes of transactions on which he or she has performed review procedures. The accountant should accumulate for further evaluation likely misstatements identified in performing the review procedures. The accountant may designate an amount below which misstatements need not be accumulated, based on his or her professional judgment. However, the accountant should recognize that aggregated misstatements of relatively small amounts could have a material effect on the interim financial information.

.26 Misstatements identified by the accountant or brought to the accountant's attention, including inadequate disclosure,[~~18~~21] should be evaluated individually and in the aggregate to determine whether material modification should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.[~~19~~22] The accountant should use his or her professional judgment in evaluating the materiality of any likely misstatements that the entity has not corrected. The accountant should consider matters such as *(a)* the nature, cause (if known), and amount of the misstatements; *(b)* whether the misstatements originated in the preceding year or interim periods of the

~~16~~19. For additional guidance regarding written management representations, see section 333, *Management Representations*, paragraphs .08–.12.

~~17~~20. If a summary of uncorrected misstatements is unnecessary because there were no uncorrected misstatements identified, this representation should be eliminated.

~~18~~21. ***For example,*** Rule 10-01 of Regulation S-X states-
The interim financial information shall include disclosures either on the face of the financial statements or in accompanying footnotes sufficient so as to make the interim information presented not misleading. Registrants may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, and detailed disclosures prescribed by Rule 4-08 of this regulation, may be omitted. However, disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant. Disclosures should encompass for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices; estimates inherent in the preparation of the financial statements; status of long-term contracts; capitalization including significant new borrowings or modification of existing financing arrangements; and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred.

~~19~~22. APB Opinion No. 28 describes the applicability of generally accepted accounting principles to interim financial information and indicates the types of disclosures necessary to report on a meaningful basis for a period of less than a full year. Paragraph 29 of Opinion No. 28 provides guidance on assessing materiality in interim periods. For example, the ~~Opinion~~ ***opinion*** states, "In determining materiality for the purpose of reporting the cumulative effect of an accounting change or correction of an error, amounts should be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings."

current year; (*c*) materiality judgments made in conjunction with the current or prior year's annual audit; and (*d*) the potential effect of the misstatements on future interim or annual periods.[~~20~~23]

.27 When evaluating whether uncorrected likely misstatements, individually or in the aggregate, are material, the accountant also should (*a*) consider the appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement and (*b*) recognize that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods.

.28 When an accountant is unable to perform the procedures he or she considers necessary to achieve the objective of a review of interim financial information, or the client does not provide the accountant with the written representations the accountant believes are necessary, the review will be incomplete. An incomplete review is not an adequate basis for issuing a review report. If the accountant cannot complete the review, the accountant should communicate that information in accordance with the guidance in paragraphs .29–.31 of this section. Nevertheless, if the accountant has become aware of material modifications that should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***, such matters should be communicated pursuant to paragraphs .29–.31 of this section.

Communications to Management and Those Charged With Governance

.29 As a result of conducting a review of interim financial information, the accountant may become aware of matters that cause him or her to believe that (*a*) material modification should be made to the interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework*** or (*b*) that the entity ***issued the interim financial information*** ~~filed the Form 10-Q or Form 10-QSB~~ before the completion of the review, ***in those circumstances in which a review is required***. In such circumstances, the accountant should communicate the matter(s) to the appropriate level of management as soon as practicable.

.30 If, in the accountant's judgment, management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should inform those charged with governance of the matters as soon as practicable. This communication may be oral or written. If information is communicated orally, the accountant should document the communication.

.31 If, in the accountant's judgment, those charged with governance do not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should evaluate whether to resign from the engagement to review the interim financial information and as the entity's auditor. The accountant may wish to consult with his or her attorney when making these evaluations.

.32 When conducting a review of interim financial information, the accountant may become aware of fraud or possible illegal acts. If the matter involves fraud, it should be brought to the attention of the appropriate level of management. If the fraud involves senior management or results in a material misstatement of the ***interim*** financial ~~statements~~ ***information***, the accountant should communicate the matter directly to those charged with governance as described in section 316, *Consideration of Fraud in a Financial Statement Audit*, paragraphs .79–.82. If the matter involves possible illegal acts, the accountant should assure himself or herself that those charged with governance are adequately informed, unless the matter is clearly inconsequential.[~~21~~24] (See section 317, *Illegal Acts by Clients*, paragraph .17.)

.33 When conducting a review of interim financial information, the accountant may become aware of significant deficiencies ~~and~~ ***or*** material weaknesses in internal control ***as it relates to the preparation of annual and interim financial information*** that should be communicated to management and those charged with governance. ***Section 325,* Communicating Internal Control Related Matters Identified in an Audit, *defines*** ~~A~~ **significant deficiency *as a deficiency, or combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Section 325 defines*** ~~is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood~~[~~22~~25] ~~that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A~~ **material weakness *as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A reasonable possibility exists when the likelihood of the event is either reasonably possible or probable as those terms are used in FASB Statement No. 5,* Accounting for Contingencies.** ~~is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.~~ The accountant also may wish to submit recommendations related to other matters that come to the accountant's attention.[~~23~~26]

.34 When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in section 380, *The Auditor's Communication With Those Charged With Governance*, as they relate to the interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to those charged with governance ~~or be satisfied, through discussion with those charged with governance, that such matters have been communicated to those charged with governance by management~~. For example, the accountant should ~~determine that~~ ***communicate with*** those charged with governance ~~are informed about the process used by management to formulate particularly sensitive accounting estimates;~~ about a change in a significant accounting policy affecting the interim financial information; about adjustments that, either individually or in the aggregate, could have a significant effect on the entity's financial reporting process; and about uncorrected misstatements aggregated by the accountant that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial ***information*** ~~statements~~ taken as a whole.[~~24~~27]

.35 The objective of a review of interim financial information differs significantly from that of an audit. Therefore, any communication the accountant may make about the quality, not just the acceptability, of the entity's accounting principles as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the quality of the entity's accounting principles that would be identified as a result of an audit.

~~20~~23. Section 312, paragraph .60 provides guidance with respect to the auditor's qualitative considerations in evaluating whether ~~the financial statements are free of material~~ misstatements ***are material***.

~~21~~*24*. The accountant may have additional communication responsibilities pursuant to section 317, *Illegal Acts by Clients*~~;~~ ~~Section 10A of the Securities Exchange Act of 1934~~; and section 316, *Consideration of Fraud in a Financial Statement Audit*.

~~22~~*[25]*. ~~The term *remote likelihood* as used in the definitions of the terms *significant deficiency* and *material weakness* has the same meaning as the term *remote* as used in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. Paragraph 3 of FASB Statement No. 5 states:~~

~~When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms *probable*, *reasonably possible*, and *remote* to identify three areas within that range, as follows:~~

~~*a. Probable*. The future event or events are likely to occur.~~
~~*b. Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.~~
~~*c. Remote*. The chance of the future events or events occurring is slight~~.

23*26*. Section 325, *Communicating Internal Control Related Matters Identified in an Audit*, provides guidance on communicating significant deficiencies and material weaknesses in internal control.

24 **27.** The presentation to those charged with governance should be similar to the summary of uncorrected misstatements included in or attached to the management representation letter that is described in paragraph .24*l* of this section.

(*continued on page 92*)

.36 If the accountant has identified matters to be communicated to those charged with governance, the accountant should attempt to make such communications with those charged with governance, or at least the chair of its audit committee ***(or a similar subgroup with a different name)***, ~~and a representative of management before the entity files its interim financial information with a regulatory agency (such as the SEC). If such communications cannot be made before the filing, they should be made as soon as practicable in the circumstances~~ ***on a sufficiently timely basis to enable those charged with governance to take appropriate action***. The communications may be oral or written. If information is communicated orally, the accountant should document the communications.

The Accountant's Report on a Review of Interim Financial Information~~25~~[28]

Form of Accountant's Review Report

.37 ***Pursuant to paragraph .03 of this standard, an accountant is not required to issue a report on a review of interim financial information; however, if the accountant is engaged to issue a written report or, based upon the guidance in paragraph .03, determines to issue a written report, the*** ~~The~~ accountant's review report accompanying interim financial information should consist of ***the following***:

a. A title that includes the word *independent*.
b. A statement that the interim financial information identified in the report was reviewed.
c. A statement that the interim financial information is the responsibility of the entity's management.
d. A statement that the review of interim financial information was conducted in accordance with standards established by the AICPA.
e. A description of the procedures for a review of interim financial information.
f. A statement that a review of interim financial information is substantially less in scope than an audit conducted in accordance with ~~generally accepted~~ auditing standards ***generally accepted in the United States***, the objective of which is an expression of an opinion regarding the financial ***information*** ~~statements~~ taken as a whole, and accordingly, no such opinion is expressed.
g. A statement about whether the accountant is aware of any material modifications that should be made to the accompanying interim financial information for it to conform with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***. The statement should include an identification of the country of origin of those accounting principles (for example, accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles).
h. The manual or printed signature of the accountant's firm.
i. The date of the review report. (Generally, the report should be dated as of the date of completion of the review procedures.~~26~~29)

In addition, each page of the interim financial information should be clearly marked as unaudited.

.38 The following is an example of a review report:~~27~~30

<u>Independent Accountant's Report</u>

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and consolidated subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended. This ~~(These)~~ interim financial information ~~(statements)~~ is ~~(are)~~ the responsibility of the company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with ~~generally accepted~~ auditing standards ***generally accepted in the United States***, the objective of which is the expression of an opinion regarding the financial ***information*** ~~statements~~ taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information ~~(statements)~~ for it ~~(them)~~ to be in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America.]*

[*Signature*]
[*Date*]

.39 An accountant may be engaged to report on a review of comparative interim financial information.[31] The following is an example of a review report on a condensed balance sheet as of March 31, 20X1, the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, and a condensed balance sheet derived from audited financial statements as of December 31, 20X0~~, that were included in Form 10-Q~~.~~28~~[32]

<u>Independent Accountant's Report</u>

We have reviewed the condensed consolidated balance sheet of ABC Company and subsidiaries as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0. ~~These financial statements are~~ ***This condensed financial information is*** the responsibility of the company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with ~~generally accepted~~ auditing standards ***generally accepted in the United States***, the objective of which is the expression of an opinion regarding the financial ***information*** ~~statements~~ taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed financial ~~statements~~ ***information*** referred to above for them to be in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America.]*

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of ABC Company and subsidiaries as of December 31, 20X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 20X1, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 20X0,

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~~25~~*[28]*. ~~Paragraphs .37 through .46 of this section provide reporting guidance for a review of interim financial information; however, an accountant is not required to issue a report on such engagements.~~

~~26~~ *29*. Other reporting issues related to the dating of reports or subsequent events are similar to those encountered in an audit of financial statements. See sections 530, *Dating of the Independent Auditor's Report*, and 560, *Subsequent Events*.

~~27~~ *30*. If interim financial information of a prior period is presented with that of the current period and the accountant has conducted a review of that information, the accountant should report on his or her review of the prior period. An example of the first sentence of such a report follows: "We have reviewed... of ABC Company and consolidated subsidiaries as of September 30, 20X1 and 20X2, and for the three-month and nine-month periods then ended...."

31. As interim financial reporting is intended to be an update to year end reporting, balance sheet information as of the most recent year end ordinarily would be presented for comparative purposes with the corresponding information as of the latest interim period. Likewise, the comparative presentation for income statement and cash flow information presented for the current interim period would be that of the corresponding interim period of the prior year.

~~28~~*[32]*. ~~Regulation S-X specifies that the following financial information should be provided in filings on Form 10-Q:~~

~~a. An interim balance sheet as of the end of the most recent fiscal quarter and a balance sheet as of the end of the preceding fiscal year that may be condensed to the same extent as the interim balance sheet.~~

~~b. Interim condensed statements of income for the most recent fiscal quarter, for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the corresponding periods of the preceding fiscal year.~~

~~c. Interim condensed cash flow statements for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter and for the corresponding period for the preceding fiscal year.~~

is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.[~~29~~33]

[*Signature*]

[*Date*]

.40 The accountant may use and make reference to another accountant's review report on the interim financial information of a significant component of a reporting entity. This reference indicates a division of responsibility for performing the review.[~~30~~34] The following is an example of report including such a reference:

Independent Accountant's Report

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and consolidated subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended. This ~~(These)~~ interim financial information ~~(statements)~~ is ~~(are)~~ the responsibility of the company's management.

We were furnished with the report of other accountants on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three-month and nine-month periods then ended, constituted 15 percent, 20 percent, and 22 percent, respectively, of the related consolidated totals.

We conducted our review~~s~~ in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information ~~(statements)~~ consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with ~~generally accepted~~ auditing standards ***generally accepted in the United States***, the objective of which is the expression of an opinion regarding the financial ***information*** ~~statements~~ taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to the accompanying interim financial information ~~(statements)~~ for it ~~(them)~~ to be in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America.]*

[*Signature*]

[*Date*]

Modification of the Accountant's Review Report

.41 The accountant's report on a review of interim financial information should be modified for departures from ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***,[~~31~~35] which include inadequate disclosure and changes in accounting principle that are not in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***. The existence of substantial doubt about the entity's ability to continue as a going concern or a lack of consistency in the application of accounting principles affecting the interim financial information would not require the accountant to add an additional paragraph to the report, provided that the interim financial information appropriately discloses such matters. Although not required, the accountant may wish to emphasize such matters in a separate explanatory paragraph of the report. See paragraphs .44–.45 of this section for examples of paragraphs that address matters related to an entity's ability to continue as a going concern.

.42 *Departure from* ~~*generally accepted accounting principles*~~ **the applicable financial reporting framework**. If the accountant becomes aware that the interim financial information is materially affected by a departure from ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***, he or she should modify the report. The modification should describe the nature of the departure and, if practicable, should state the effects on the interim financial information. Following is an example of such a modification of the accountant's report.

[*Explanatory* ~~*third*~~ *paragraph*]

Based on information furnished to us by management, we believe that the company has excluded from property and debt in the accompanying balance sheet certain lease obligations that we believe should be capitalized to conform with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America]*. This information indicates that if these lease obligations were capitalized at September 30, 20X1, property would be increased by $______, long-term debt by $______, and net income and earnings per share would be increased (decreased) by $________, $_________, $________, and $________, respectively, for the three-month and nine-month periods then ended.

[*Concluding paragraph*]

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying interim financial information ~~(statements)~~ for it ~~(them)~~ to be in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America]*.

.43 *Inadequate disclosure*. The information necessary for adequate disclosure is influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of APB Opinion No. 28, paragraph 30, which is applicable to summarized financial statements of public companies, are considerably less extensive than those necessary for annual financial statements that present financial position, results of operations, and cash flows in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***.[~~32~~36] If information that the accountant believes is necessary for adequate disclosure in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***[~~33~~37] is not included in the interim financial information, the accountant should modify the report and, if practicable, include the necessary information in the report. The following is an example of such a modification of the accountant's report:

[*Explanatory* ~~*third*~~ *paragraph*]

Management has informed us that the company is presently ~~contesting deficiencies in federal income taxes proposed by the Internal Revenue Service for the years 20X1 through 20X3 in the aggregate amount of approximately $_____,~~ ***defending a claim regarding* [describe the nature of the loss contingency]** and that the extent of the company's liability, if any, and the effect on the accompanying information ~~(statements)~~ is not determinable at this time. The information ~~(statements) fail(s)~~ ***fails*** to disclose these matters, which we believe are required to be disclosed in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America]*.

[*Concluding paragraph*]

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying interim financial information ~~(statements)~~ for it ~~(them)~~ to be in conformity with **[identify the applicable financial reporting framework; for example,** *accounting principles generally accepted in the United States of America]*.

~~29~~*33*. If the auditor's report on the preceding year-end financial statements was other than unqualified, referred to other auditors, or included an explanatory paragraph because of a going-concern matter or an inconsistency in the application of accounting principles, the last paragraph of the illustrative report in paragraph .39 should be appropriately modified.

~~30~~*34*. See section 543.

~~31~~*35*. If the circumstances contemplated by Rule 203, *Accounting Principles [ET sec. 203 par. 01]*, are present, the accountant should refer to the guidance in section 508, *Reports on Audited Financial Statements*, paragraph .15.

~~32~~*36*. ***For example***, APB Opinion No. 28, paragraph 32, states that "there is a presumption that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by generally accepted accounting principles and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context." See footnote 21 of this section for additional disclosure requirements.

~~33~~*37*. Such disclosures include those set forth in section 341 paragraph .10. If the accountant determines that disclosure about the entity's possible inability to continue as a going concern is inadequate, a departure from generally accepted accounting principles exists.

(continued on page 96)

.44 *Going-concern paragraph was included in the prior year's audit report; conditions giving rise to the paragraph continue to exist.* If (a) the auditor's report for the prior year end contained an explanatory paragraph indicating the existence of substantial doubt about the entity's ability to continue as a going concern, (b) the conditions that raised such doubt continued to exist as of the interim reporting date covered by the review, and (c) there is adequate and appropriate disclosure about these conditions in the interim financial information, the accountant is not required to modify his or her report. However, the accountant may add an explanatory paragraph to the review report, after the concluding paragraph, emphasizing the matter disclosed in the audited financial statements and the interim financial information. The following is an example of such a paragraph.

> Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended discloses that the Company was unable to renew its line of credit or obtain alternative financing at December 31, 20X1. Our auditor's report on those financial statements includes an explanatory paragraph referring to the matters in note 4 of those financial statements and indicating that these matters raised substantial doubt about the Company's ability to continue as a going concern. As indicated in note 3 of the Company's unaudited interim financial ~~statements~~ ***information*** as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

.45 *Going-concern paragraph was not included in the prior year's audit report; conditions or events exist as of the interim reporting date covered by the review that might be indicative of the entity's possible inability to continue as a going concern.* If (*a*) conditions or events exist as of the interim reporting date covered by the review that might be indicative of the entity's possible inability to continue as a going concern, and (*b*) there is adequate and appropriate disclosure about these conditions or events in the interim financial information, the accountant is not required to modify his or her report. However, the accountant may add an explanatory paragraph to the review report, after the concluding paragraph, emphasizing the matter disclosed in the interim financial information. The following is an example of such a paragraph.

> As indicated in note 3, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Subsequent Discovery of Facts Existing at the Date of the Accountant's Report *or Completion of the Interim Review Procedures*

.46 Subsequent to the date of the accountant's review report or the completion of the interim review procedures, if a report is not issued, the accountant may become aware that facts existed at the date of the review report (or the completion of the review procedures) that might have affected the accountant's report (or conclusion, if a report is not issued) had he or she then been aware of those matters. Because of the variety of conditions that might be encountered, the specific actions to be taken by the accountant in a particular case may vary with the circumstances. In any event, the accountant should consider the guidance in section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.*

Client's Representation Concerning a Review of Interim Financial Information

.47 If a client represents in a ~~document filed with a regulatory agency (see paragraph .03 of this section for the SEC requirement) or issued to stockholders or third parties~~ ***report, document, or written communication containing the reviewed interim financial information*** that the accountant has reviewed the interim financial information ~~included in the document~~, the accountant should advise the entity that his or her review report must be included in the ***report,*** document, ***or written communication***. If the client will not agree to include the accountant's review report, the accountant should perform the following procedures.

- Request that the accountant's name be neither associated with the interim financial information nor referred to in the document.
- If the client does not comply with the request, advise the client that the accountant will not ~~consent~~ ***permit*** either ~~to~~ the use of his or her name or ~~to~~ reference to him or her.
- ***Communicate the client's noncompliance with the request to those charged with governance.***
- When appropriate, recommend that the client consult with its legal counsel about the application of relevant laws and regulations to the circumstances.
- Consider what other actions might be appropriate.[~~34~~38]

.48 If a client represents in a document filed with a regulatory agency ~~(see paragraph .03 of this section for the SEC requirement)~~ or issued to stockholders or third parties that the accountant has reviewed the interim financial information included in the document, and the accountant has been unable to complete the review of the interim financial information, the accountant should refer to paragraph*s* .28 ***and*** *.47* of this section for guidance.

~~34~~38. In considering what actions, if any, may be appropriate in these circumstances, the accountant should consider consulting his or her legal counsel.

Interim Financial Information Accompanying Audited Financial Statements

.49 Interim financial information may be presented as supplementary information outside audited financial statements. In such circumstances, each page of the interim financial information should be clearly marked as unaudited. If management chooses or is required to present interim financial information in a note to the audited financial statements, the information also should be clearly marked as unaudited.

.50 The auditor ordinarily need not modify his or her report on the audited financial statements to refer to his or her having performed a review in accordance with this section or to refer to the interim financial information accompanying the audited financial statements because the interim financial information has not been audited and is not required for the audited financial statements to be fairly stated in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework***. The auditor's report on the audited financial statements should, however, be modified in the following circumstances:

a. The interim financial information included in a note to the financial statements, including information that has been reviewed in accordance with this section, is not appropriately marked as unaudited. (In these circumstances the auditor should disclaim an opinion on the interim financial information.)

b. The interim financial information accompanying audited financial statements does not appear to be presented in conformity with ~~generally accepted accounting principles~~ ***the applicable financial reporting framework*** (see paragraphs .42~~and~~–.43 of this section). However, the auditor need not modify his or her report on the audited financial statements if his or her separate review report, which refers to those circumstances, is presented with the information.

~~c. The selected quarterly financial data required by item 302(a) of Regulation S-K is omitted. The following is an example of a paragraph that should be added to the auditor's report if the selected quarterly financial data required by item 302(a) is omitted. The company has not presented the selected quarterly financial data specified in item 302(a) of Regulation S-K that the Securities and Exchange Commission requires as supplementary information to the basic financial statements.~~

~~d. The selected quarterly financial data required by item 302(a) of Regulation S-K has not been reviewed. The following is an example of a paragraph that should be added to the auditor's report if the selected quarterly financial data required by item 302(a) has not been reviewed.~~

~~The selected quarterly financial data on page xx contains information that we did not audit, and, accordingly, we do not express an opinion on that data.~~

~~We attempted but were unable to review the quarterly data in accordance with standards established by the American Institute of Certified Public Accountants because we believe that the company's internal control for the preparation of interim financial information does not provide an adequate basis to enable us to complete such a review.~~

DOCUMENTATION

.51 The accountant should prepare documentation in connection with a review of interim financial information, the form and content of which should be designed to meet the circumstances of the particular engagement. Documentation is the principal record of the review procedures performed and the conclusions reached by the accountant in performing the review.~~35~~39 Examples of documentation are review programs, analyses, memoranda, and letters of representation. Documentation may be in paper or electronic form, or other media. The quantity, type, and content of the documentation are matters of the accountant's professional judgment.

.52 Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation the accountant should prepare. However, the documentation should include any findings or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. In addition, the documentation should (*a*) enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of the review procedures performed; (*b*) identify the engagement team member(s) who performed and reviewed the work; and (*c*) identify the evidence the accountant obtained in support of the conclusion that the interim financial information being reviewed agreed or reconciled with the accounting records (see paragraph **.18***d* of this section).

EFFECTIVE DATE

.53 This section is effective for ***reviews of interim financial information for*** interim periods ~~within fiscal years~~ beginning after December 15, ~~2002~~*2009*. Earlier application of the provisions of this section is permitted.

APPENDIX A—ANALYTICAL PROCEDURES THE ACCOUNTANT MAY CONSIDER PERFORMING WHEN CONDUCTING A REVIEW OF INTERIM FINANCIAL INFORMATION

.54

A1. Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the interim financial information. These procedures may consist of comparing interim financial information with prior period information, actual interim results with anticipated results (such as budgets or forecasts), and recorded amounts or ratios with expectations developed by the accountant. Examples of analytical procedures an accountant may consider performing in a review of interim financial information include

- comparing current interim financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current interim financial information with corresponding information in (*a*) budgets, using expected rates, and (*b*) financial information for prior periods).[1]
- comparing current interim financial information with relevant nonfinancial information.
- comparing ratios and indicators for the current interim period with expectations based on prior periods, for example, performing gross profit analysis by product line and operating segment using elements of the current interim financial information and comparing the results with corresponding information for prior periods. Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- comparing ratios and indicators for the current interim period with those of entities in the same industry.
- comparing relationships among elements in the current interim financial information with corresponding relationships in the interim financial information of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.
- comparing disaggregated data. The following are examples of how data may be disaggregated.
  — By period, for example, financial statement items disaggregated into quarterly, monthly, or weekly amounts
  — By product line or operating segment
  — By location, for example, subsidiary, division, or branch

A2. Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

APPENDIX B—UNUSUAL OR COMPLEX SITUATIONS TO BE CONSIDERED BY THE ACCOUNTANT WHEN CONDUCTING A REVIEW OF INTERIM FINANCIAL INFORMATION

.55

B1. The following are examples of situations about which the accountant would ordinarily inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Computation of earnings per share in a complex capital structure
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates,[1] such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related-party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

APPENDIX C—ILLUSTRATIVE MANAGEMENT REPRESENTATION LETTERS FOR A REVIEW OF INTERIM FINANCIAL INFORMATION

.56

C1. The following illustrative management representation letters, which relate to a review of interim financial information prepared in conformity with ~~generally accepted accounting principles~~ ***an applicable financial reporting framework***, are presented for illustrative purposes only. The first letter is designed to be used in conjunction with the representation letter provided by management in

~~35~~39. However, an accountant would not be precluded from supporting his or her conclusions by other means in addition to the *review* documentation.

1. The accountant should exercise caution when comparing and evaluating current interim financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and susceptibility of such information to manipulation and misstatement by management to reflect desired interim results

1. The accountant may wish to refer to the guidance in section 342, *Auditing Accounting Estimates*, paragraphs .05–.06.

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connection with the audit of the financial statements of the prior year. The second illustrative representation letter may be used independently of any other representation letter.

C2. The introductory paragraph of the letters should specify the financial ~~statements~~ ***information*** and periods covered by the accountant's report, for example, "condensed balance sheets of XYZ Company as of June 30, 20X1 and 20X2, and the related condensed statements of income and retained earnings and cash flows for the three-month and nine-month periods then ended." The written representations to be obtained should be based on the circumstances of the engagement and the nature and basis of presentation of the ***interim*** financial ~~statements~~ ***information*** being reviewed. Appendix B, "Additional Illustrative Representations," of section 333, *Management Representations*, presents examples of such representations. Illustrative representations for specialized industries are presented in AICPA Audit and Accounting Guides.

C3. If matters exist that should be disclosed to the accountant, they should be indicated by modifying the related representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the interim financial ~~statements~~ ***information***, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in note X to the ***interim*** financial ~~statements~~ ***information***, no events have occurred. . . ." In appropriate circumstances, item 10 of the second illustrative representation letter could be modified as follows: "The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of segment A, as disclosed in note X to the interim financial information, which are discussed in the minutes of the June 7, 20X2, meeting of the board of directors (or disclosed to you at our meeting on June 15, 20X2)." Similarly, if management has received a communication regarding an allegation of fraud or suspected fraud, item 7 of the first illustrative representation letter and item 9 of the second illustrative representation letter could be modified as follows: "Except for the allegation discussed in the minutes of the December 7, 20X1, meeting of the board of directors (or disclosed to you at our meeting on October 15, 20X1), we have no knowledge of any allegations of fraud or suspected fraud affecting the company received in communications from employees, former employees, analysts, regulators, short sellers, or others."

C4. The qualitative discussion of materiality used in the illustrative letters is adapted from the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.

C5. Certain terms are used in the illustrative letters that are described elsewhere in authoritative literature. Examples are *fraud*, in section 316, *Consideration of Fraud in a Financial Statement Audit*, and *related parties*, in section 334, *Related Parties*, footnote 1). To avoid misunderstanding concerning the meaning of such terms, the accountant may wish to furnish those definitions to management or request that the definitions be included in the written representations.

C6. The illustrative letters assume that management and the accountant have reached an understanding on the limits of materiality for purposes of the written representations. However, it should be noted that a materiality limit would not apply for certain representations, as explained in section 333, paragraph .08.

1. Illustrative Short-Form Representation Letter for a Review of Interim Financial Information ~~(Statements)~~

[*This representation letter is to be used in conjunction with the representation letter for the audit of the financial statements of the prior year. Management confirms the representations made in the representation letter for the audit of the financial statements of the prior year end as they apply to the interim financial information, and makes additional representations that may be needed for the interim financial information.*]

[*Date*]

To [*Independent Accountant*]:

We are providing this letter in connection with your review of the [*identification of interim financial information ~~(statements)~~*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of determining whether any material modifications should be made to the [*consolidated*] interim financial information ~~(statements)~~ for it ~~(them)~~ to conform with ***[identify the applicable financial reporting framework; for example,*** *accounting principles generally accepted in the United States of America*, **including, if appropriate, an indication as to the appropriate form and content of interim financial information (for example, Article 10 of SEC Regulation S-X)*]***. We confirm that we are responsible for the fair presentation of the [*consolidated*] interim financial information ~~(statements)~~ in conformity with ***[identify the applicable financial reporting framework; for example,*** *generally accepted accounting principles]* ***and that we are responsible for establishing and maintaining controls that are sufficient to provide a reasonable basis for the preparation of reliable interim financial information in accordance with [identify the applicable financial reporting framework; for example, generally accepted accounting principles].***

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, [*as of (date of accountant's report or completion of review)*,] the following representations made to you during your review.

1. The interim financial information ~~(statements)~~ referred to above has ~~(have)~~ been prepared and presented in conformity with ***[identify the applicable financial reporting framework; for example,*** *generally accepted accounting principles]* applicable to interim financial information.
2. We have made available to you
   a. all financial records and related data.
   b. all minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared. All significant board and committee actions are included in the summaries.
3. We believe that the effects of any uncorrected financial statement misstatements aggregated by you during the current review engagement and pertaining to the interim period(s) in the current year, as summarized in the accompanying schedule, are immaterial, both individually and in the aggregate, to the interim financial information ~~(statements)~~ taken as a whole.[1]
4. There are no significant deficiencies ~~and~~ ***or*** material weaknesses, in the design or operation of internal controls ~~which could adversely affect the company's ability to record, process, summarize, and report interim financial data~~ ***as it relates to the preparation of both annual and interim financial information***.
5. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
6. We have no knowledge of any fraud or suspected fraud affecting the company involving
   a. management;
   b. employees who have significant roles in internal control; or
   c. others where the fraud could have a material effect on the interim financial information.
7. We have no knowledge of any allegations of fraud or suspected fraud affecting the company ***received*** in communications from employees, former employees, analysts, regulators, short sellers, or others.
8. We have reviewed our representation letter to you dated [*date of representation letter relating to most recent audit*] with respect to the audited financial statements for the year ended [*prior year-end date*]. We believe that representations A, B, and C within that representation letter do not apply to the interim financial information ~~(statements)~~ referred to above. We now confirm those representations 1 through X, as they apply to the interim financial information ~~(statements)~~ referred to above, and incorporate them herein, with the following changes:

[*Indicate any changes.*]

1. If a summary of uncorrected misstatements is unnecessary because no uncorrected misstatements were identified, this representation should be eliminated.

9. [*Add any representations related to new accounting or auditing standards that are being implemented for the first time.*]

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned interim financial information ~~(statements)~~.

[*Name of chief executive officer and title*]

[*Name of chief financial officer and title*]

[*Name of chief accounting officer and title*]

2. Illustrative Representation Letter for a Review of Interim Financial Information ~~(Statements)~~

[*This representation letter is similar in detail to the management representation letter used for the audit of the financial statements of the prior year and thus need not refer to the written management representations received in the most recent audit.*]

[*Date*]

To [*Independent Accountant*]:

We are providing this letter in connection with your review of the [*identification of interim financial information ~~(statements)~~*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of determining whether any material modifications should be made to the [*consolidated*] interim financial information ~~(statements)~~ for it ~~(them)~~ to conform with ***[*identify the applicable financial reporting framework; for example**, accounting *principles generally accepted in the United States of America,* **including, if appropriate an indication as to the appropriate form and content of interim financial information (for example, Article 10 of Regulation S-X)*]***. We confirm that we are responsible for the fair presentation of the [*consolidated*] interim financial information ~~(statements)~~ in conformity with ***[*identify the applicable financial reporting framework; for example**, generally accepted accounting principles*] ***and that we are responsible for establishing and maintaining controls that are sufficient to provide a reasonable basis for the preparation of reliable interim financial information in accordance with [*identify the applicable financial reporting framework; for example, generally accepted accounting principles*]***.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, [*as of* (*date of accountant's report or the completion of the review*)], the following representations made to you during your review.

1. The interim financial information ~~(statements)~~ referred to above has ~~(have)~~ been prepared and presented in conformity with ***[*identify the applicable financial reporting framework; for example,** generally accepted accounting principles*]*** applicable to interim financial information ~~(statements)~~.
2. We have made available to you
   a. all financial records and related data.
   b. all minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared. All significant board and committee actions are included in the summaries.
3. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the interim financial information.
5. We believe that the effects of any uncorrected financial statement misstatements aggregated by you during the current review engagement and pertaining to the interim period(s) in the current year, as summarized in the accompanying schedule, are immaterial, both individually and in the aggregate, to the interim financial information ~~(statements)~~ taken as a whole.~~+~~2
6. There are no significant deficiencies ~~and~~ ***or*** material weaknesses, in the design or operation of internal control~~s which could adversely affect the company's ability to record, process, summarize, and report interim financial data~~ ***as it relates to the preparation of both annual and interim financial information***.
7. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
8. We have no knowledge of any fraud or suspected fraud affecting the company involving
   a. management;
   b. employees who have significant roles in internal control; or
   c. others where the fraud could have a material effect on the interim financial information.
9. We have no knowledge of any allegations of fraud or suspected fraud affecting the company received in communications from employees, former employees, analysts, regulators, short sellers, or others.
10. The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
11. The following have been properly recorded or disclosed in the interim financial information ~~(statements)~~:
    a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
    b. Guarantees, whether written or oral, under which the company is contingently liable.
    c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties* ***(AICPA, Technical Practice Aids, ACC sec. 10,640)***. [*Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.*]
12. There are no
    a. violations or possible violations of laws or regulations whose effects should be considered for disclosure in the interim financial information ~~(statements)~~ or as a basis for recording a loss contingency.
    b. unasserted claims or assessments that are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.
    c. other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.
13. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets; nor has any asset been pledged as collateral.
14. The company has complied with all aspects of contractual agreements that would have a material effect on the ***interim*** financial ~~statements~~ ***information*** in the event of noncompliance.
15. [*Add additional representations that are unique to the entity's business or industry. See ~~paragraph .21 of this section and~~ section 333,* Management Representations, *paragraph .17*).]
16. [*Add any representations related to new accounting or auditing standards that are being implemented for the first time.*]

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned interim financial information ~~(statements)~~.

[*Name of chief executive officer and title*]

[*Name of chief financial officer and title*]

[*Name of chief accounting officer and title*]

~~+~~2. If a summary of uncorrected misstatements is unnecessary because no uncorrected misstatements were identified, this representation should be eliminated.

(*continued on page 100*)

This statement, Interim Financial Information, *was adopted unanimously by the assenting votes of the 19 members of the Auditing Standards Board (ASB).*

Auditing Standards Board (2008–2009)

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Cassandra Camp	Beth A. Schneider
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Note: *Statements on Auditing Standards are issued by the ASB, the senior technical body of the AICPA designated to issue pronouncements on auditing matters. Rule 202,* Compliance With Standards *[ET sec. 202 par. 01], of the AICPA Code of Professional Conduct requires compliance with these standards in an audit of a nonissuer.*

SSARS 18

Statement on Standards for Accounting and Review Services No. 18, *Applicability of Statements on Standards for Accounting and Review Services*

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100 par. .01)

1. The purpose of this amendment is to revise AR section 100 so that Statements on Standards for Accounting and Review Services (SSARSs) do not apply when the provisions of AU section 722, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1), apply. New language is shown in boldface italics; deleted language is shown by strikethrough.

INTRODUCTION

.01 This statement ~~sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonissuer to his or her client or third parties.~~ ***establishes standards and provides guidance on compilations and reviews of financial statements.*** The accountant should not submit unaudited financial statements of a nonissuer to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this section applicable to a compilation engagement.

a. *Compilation of financial statements.*[1] If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.

i. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see paragraphs .13–.23 ***and .54–.76*** for reporting requirements.

ii. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see paragraphs .24–.27 for required communications to management.

In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

In each of the above circumstances, the performance requirements in paragraphs .05 and ~~.09–.12~~ ***.08–.11*** apply.

b. *Review of financial statements.* If the accountant performs a review, see paragraphs .05 and .28–~~.53~~ ***.76*** for performance and reporting requirements. ***Statements on Standards for Accounting and Review Services are not applicable to reviews of interim financial information if***

i. the entity's latest annual financial statements have been audited by the accountant or a predecessor;

ii. the accountant has been engaged to audit the entity's current year financial statements, or the accountant audited the entity's latest annual financial statements and expects to be engaged to audit the current year financial statements; and

iii. the client prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

Accountants engaged to perform reviews of interim financial information when the previously mentioned conditions in i–iii are met should perform such reviews in accordance with AU section 722,* Interim Financial Information *(AICPA,* Professional Standards, *vol. 1).

1. See appendix A [paragraph .97], "Compilation of Financial Statements," for a flowchart regarding the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement.

2. This amendment is effective for compilations and reviews of financial statements for periods beginning after December 15, 2009. Early application is permitted.

This statement, Applicability of Statements on Standards for Accounting and Review Services, *was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee (ARSC).*

Accounting and Review Services Committee (2008–2009)

Carolyn H. McNerney, *Chair*	Douglas S. Mathison
Gerald W. Burns	Charles J. McElroy
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Note: *SSARSs are issued by the ARSC, the senior technical body of the AICPA designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Rule 202,* Compliance With Standards *[ET sec. 202 par. .01], of the AICPA Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARSs to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARSs.*

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Accountant wanted by the wholesale/trade (Grocery) company in Hillside, New Jersey. Must have Masters degree in Accounting or Finance. Must speak, read and write Korean. Resume to: **Seoul Shik Poom, Inc., 10-16 Montgomery St., Hillside, NJ 07205. Attn: Ryan Lee.**

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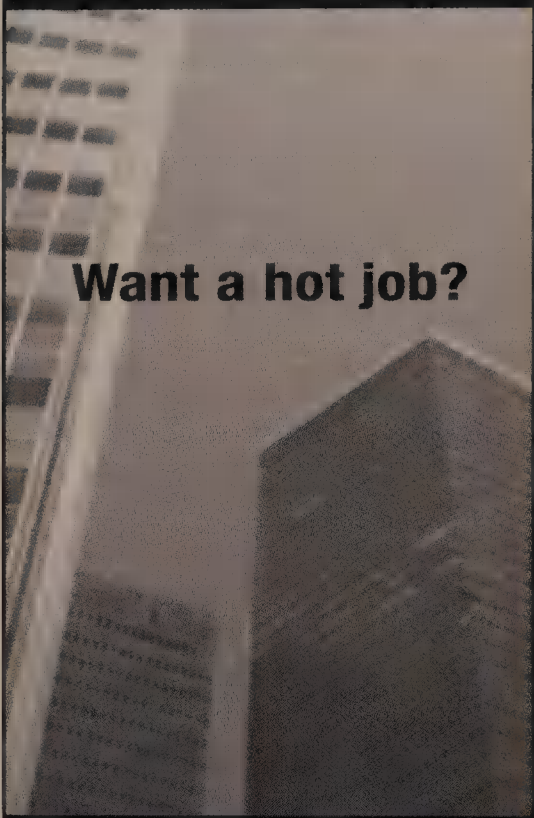

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THE LAST WORD

I am a sole practitioner. I always wanted to be my own boss, and about 11 years ago, taking a "leap of faith" that I would have clients, I left the small firm where I had worked for 14 years to open my own home-based office. Looking back, I ask myself, "Why didn't I do that five years earlier?" Some consultants say sole practitioners are a dying breed. I don't agree; there will be always a place for the sole practitioner because of the trusting relationship that develops between the practitioner and small business owners, the foundation of the sole practice.

Robert F. Fay, CPA, Canton, Ohio

The personal relationship I have with my clients has allowed me to help them weather the recession. I've been helping them adjust their budgets and plan strategies to be more efficient and also to be ready when the economy turns the corner. Many sole practitioners work from an outside office. I work out of my house. Because I have a home office and no staff, I already have low overhead, but I follow the advice I give to clients: I am reviewing all of my expenses and putting more into savings as a way to deal with the recession.

My success as a practitioner has come from community involvement. I am not listed in the Yellow Pages; I don't have a brochure; and I don't do any marketing. What I do, however, is get *actively* involved in my community. I don't just attend meetings; I work on committees and assume leadership roles. I've built my practice through this type of engagement. Business owners who are also active are drawn to others who show the same type of commitment.

One of my favorite community organizations is Habitat for Humanity. In 1987, shortly after reading an article about President Jimmy Carter's involvement with Habitat, I learned that a group of people was forming a Habitat chapter in Canton (Ohio). I was among the initial group of 15 people who got it going. Since then, I served 12 years on Habitat's board, was treasurer for more than a decade, and have been president. That first year our Habitat chapter raised $8,619, and took 18 months to build our first house. Within six years, we were raising more than $1 million a year from the greater Canton area. Today our chapter has thousands of volunteers who build about 25 houses a year.

Financial literacy is a passion of mine, which got me involved with a local high school, whose accounting program was dying. With the support of the AICPA and the Ohio Society of Certified Public Accountants (OSCPA), I helped organize an effort to save the program. It took six years of working with the teacher and getting other CPAs involved, but the program, which only had three students left, now has 18. I'd like to see CPAs all over the country help high schools rebuild their programs.

My wife, Peg, and I love music, especially the Beatles. As serious collectors, we even travel to music auctions at Christie's in New York several times a year. Our collecting started about 10 years ago when we found a box of 45s buried in garage debris. The box contained some singles the Beatles had recorded before they were big. That "find" sparked our interest, and we began collecting Beatles memorabilia—baseball cards, posters, prints, albums and other stuff. I have a few of the items on display in my office. I also have a framed drumstick Dennis Wilson of the original Beach Boys had tossed to an audience. My wife, who was then in grade school, was at the concert and caught it. The drumstick is one of her treasures. When clients meet with me in my office, the displayed music memorabilia serves as a conversation piece and reminds us of a time before the world got so busy and stressful.

—As told to Linda Segall